# THE ECONOMICS

OF THE

# RECOVERY PROGRAM

THESE *essays had their origin in private conversations among the authors. It is hardly necessary to say that they are in no sense a pronouncement from the Department of Economics in Harvard University, or that they commit no one but the authors themselves.*

THE AUTHORS

# THE ECONOMICS
## OF THE
# RECOVERY PROGRAM

*by*

DOUGLASS V. BROWN
EDWARD CHAMBERLIN
SEYMOUR E. HARRIS
WASSILY W. LEONTIEF
EDWARD S. MASON
JOSEPH A. SCHUMPETER
OVERTON H. TAYLOR

*of Harvard University*



WHITTLESEY HOUSE
McGRAW-HILL BOOK COMPANY, INC.
NEW YORK AND LONDON
1934

THIRD PRINTING

*Published by*

WHITTLESEY HOUSE

*Trade Division of the*

MCGRAW-HILL BOOK COMPANY, INC.



*Printed in the United States of America by*
*The Maple Press Company, York, Pa.*

# CONTENTS

# INTRODUCTION

THE common aim of these essays is to analyze, in the light of economic experience and principle, the present economic policy of this country with reference to the goal of recovery. We wish to take up, one by one, the major groups of measures, and to answer for each of them such questions as: What is the immediate effect it is meant to produce? Are the means, chosen in every case, likely to produce that specific effect? And will that effect, if actually produced, or will the means as such, help to bring about recovery? For exposition of the details of acts and codes we must refer the reader to other sources. Recommendation of proposals of our own is no part of the plan of this volume. It may best be described as a little handbook of, or guide to, the main ideas underlying the policy of recovery and the main arguments about it.

Readers will, by this time, be sufficiently aware of the conflict of opinion on the subject to expect to find plenty of criticism in these pages. This expectation is perfectly justified. Unavoidably,

there *is* plenty of criticism. And if these essays are to render the modest service of clarification which it is their aim to render, it is necessary to define the nature of this criticism at the outset and to reply in advance to some objections which will not fail to arise in the reader's mind.

First of all: We have not tried to be non-political. There was no need of *trying*, for, as a group, we *are*. By this we mean that there has been no intention to defend or attack either the Administration which is responsible for the measures discussed or any political party, and that the absence of such intention is not due to virtuous effort, but simply to the fact that the writers who contributed these essays, although colleagues and friends, probably represent pretty much all of the existing shades of political preference. Some of them are in hearty sympathy with what they conceive to be the spirit of the government's policy. Such parallelism of views as the reader will observe—no effort has been made to secure conformity—is due to their scientific training and cannot, by the nature of the case, be attributed to political intention or allegiance. It is true that *any* criticism is at present likely to be voted down as "reactionary." But the reader can easily satisfy himself that measures much more "radical" than any actually taken would not be open to the main critical

comments here presented and that the authors are very far indeed from believing that nineteenth century individualism is the summit of wisdom for all times. It is, besides, by no means as easy to classify present economic policies under political headings as most people seem to think. Inflation, for instance, has acquired some association with "progressive" views. But it should not be forgotten that it never was, historically speaking, a part of liberal or radical programs. It is even but justice to state that serious socialism has always stood for what is known as sound money. Again, measures in the interest of agriculture could be classed as "liberal" only at the expense of including in that term the policies of the present governments of Germany and Italy. Restriction of production and organization of the trades is *not* planning in any sense which would spell progressive reform of fundamental social institutions. The kind of planning that has been undertaken so far may mean no more than the emergence of the cartel. There is plenty of freedom for very different social interpretations even as regards the policy with reference to trade unions, while many measures, of course, do not carry any political connotation at all.

While there has been no effort to be nonpolitical, there was considerable effort to be

non-technical. The fact must be faced that it is impossible to present results of economic analysis in a way both simple and accurate. We have, however, done without anything which could fairly be accused of savoring of technique or scientific apparatus, and all that is necessary for the reader to bear in mind is that what he will read is not the whole case in all its ramifications and qualifications, which we are as far from claiming as we are from pretending to omniscience or immunity from honest error. This difficulty is in any case a minor one. For the real trouble with the public mind in matters of economic policy is not so much that it fails to follow complicated arguments, or to realize, as it does in other fields, that there are things the understanding of which calls for laborious study, but rather the opposite one, namely, that it obstinately refuses to trust to its own common sense, where this common sense could be expected to speak out with no uncertain voice. In fact, no one who tries to analyze public opinion can fail to be struck by the discovery that what it believes is hardly ever the obvious. The first and foremost task of professional criticism is now, as it has always been, to defend plain truth which really is not recondite at all. If people would only believe such things as that you cannot increase economic welfare by

producing less all round and other similar ones which are, at all events, much nearer the truth than their opposites, the worst errors would be avoided and what a wiser, happier, richer place the modern world would be!

These essays analyze merely the recovery aspect of current measures. It may be urged with some justice that this aspect is not the only one and that criticism which fails to take account of the larger issues involved misses the essential point. To show that we recognize this, Mr. Taylor has undertaken to deal with those wider aspects. But the problem of recovery is nevertheless a self-contained whole. It can be treated by itself, quite apart from the fact that helping toward recovery was and is the main goal of official policy as authoritatively stated. Everyone, it is true, is within his rights if he says: "I do not want recovery only, or recovery at any price, I do want other things more." But he ought to know how far this is, and how far this is not, compatible with speedy recovery. He must be able to count the costs of striving after other—perhaps higher—aims. Social idealism is a fine thing if acted upon with a clear perception of the sacrifices involved *for all classes*. It is but foolishness if it rests on no other foundation than definite and provable economic error.

It is unavoidable that, here and there, the authors should reveal, expressly or by implication, what they think could, or ought to, be done in order to bring about recovery. But it was no part of our plan to suggest measures of remedial policy. We do not see any force in the question: What remedies have you yourselves to offer? Analysis and criticism have their place quite independently of the existence or nature of alternative proposals. They render an essential service by supplying *one* element vital to intelligent opinion. And they render it the more efficiently the less they are burdened with any proposals of the critic. Besides, if medicine taught only which prescriptions do *not* help, it would still contribute substantially to public health.

In some countries, there is a disposition to disapprove of any argument which may, directly or by inference, reflect adversely on government action taken in emergency. Respect for the great tradition of American freedom of opinion and speech prevents us from discussing any such view here. We are sure, all of us, that honest criticism will be more welcome to the most fervent supporters, reasoned endorsement more welcome to the most ardent opponents, of government policy, than thoughtless cheers would be to the one and narrow root-and-branch condemnation would be to the other—or any dogmatism to either.

THE AUTHORS

# THE ECONOMICS

OF THE

# RECOVERY PROGRAM

# DEPRESSIONS

*By* Joseph A. Schumpeter

## *Can We Learn from Past Experience?*

To many people, who today speak of unprecedented disaster, historic precedent is not only inconclusive but distasteful. There is some practical wisdom in this attitude, as far at least as it implies protest against misleading analogies in a world in which nothing ever reproduces itself with the mechanical exactness of a laboratory experiment. But recurrent the depressions are and certain features repeat themselves; and these recurrent features as well as those which are peculiar to any one crisis show some truths, which it would be much more laborious to establish without such illustrative material. Take for instance the crisis which occurred in this country in 1896. Up to this date the crises of the nineteenth century had been international. But the American crisis of 1896 was not. In all other countries 1896 was a year of fair business—of distinct prosperity in some, of moderate prosperity in others. Common

sense leads us to look for some cause peculiar to this country. And we have not far to seek. The peculiar cause stands out clearly, and every history of business cycles registers it—the Bryan campaign and the threat of silver inflation. The case is instructive. Many persons, perhaps most, would argue that Americans, expecting inflation, would have rushed into contracts, started building, ordered industrial equipment, "bought now," thereby producing a boom. In fact, they did not. On the contrary, although underlying conditions were by no means unfavorable for an upswing, business went to pieces. But as soon as sound money was assured, the wheels of the economic machine started moving again of themselves. Lesson: our industrial system is sensitive to political, especially monetary, disturbances. The system may be a very imperfect one, to be improved or even quite cast aside. But this is beside the point when we discuss crises and recovery. Nothing prevents recovery as effectively as fear of political action; nothing promotes it as does firm and sober handling of the existing situation under the existing conditions.

## 1825

The international crisis of 1825 is still more instructive. We must, however, speak of it in terms of English experience, which was in some

respects curiously like the course of events in this country since the World War. The Napoleonic Wars were over and so was the postwar crisis (1815). Forty years of what was an unexampled rate of development—that process which is popularly known as the "industrial revolution" and the outstanding feature of which, in the industrial field, was the emergence of a mechanized textile, especially cotton, industry—had established England's industrial, colonial expansion and the capture of the trade of the other belligerent nations, her commercial supremacy. Both these causes, changing the whole of her economic life and her social structure, were bound to bring about a period of painful readjustment to the conditions of a new equilibrium. In international finance, England became a great lending or "creditor" country. As she had not been a debtor country before, the change was less spectacular than the corresponding change in America's position after 1914. Still it was then that she established herself as the financial center of the world. Resumption of specie payments (1819) *did not interrupt her prosperous march at all*, but the Act of 1822, which facilitated the expansion of credit by the provincial banks, produced all the consequences of what is euphemistically called "elasticity of the credit system." A high protective tariff gave an artificial stimulus to profits and to stock

exchange speculation. But the price-level from 1814 to 1825 showed a sharply declining trend.

The annals of the period abound with reports of all imaginable symptoms of "prosperity." The progress of the working classes—starting, it is true, from a deplorable level—was considerable. The well-to-do prospered, and that conventional living, which we are accustomed to associate with the English bourgeois, was a much admired achievement of that boom. The agricultural sector had not quite its share, as the increase of capacity in response to the panic demand of the war years had led to depressed prices and rents.

Then came the crash, and reaction and readjustment, both of the most typical kind. The first thing to break down was speculation, which had persisted through 1824 and the greater part of 1825 because of the failure of the rate of discount to rise adequately. Next came a collapse among banks, seventy of them failing within six weeks. Thereafter everything else went on exactly as the usual statistical picture of crises has it.

The financial crisis was over before the year was out, but roughly three years of depression followed. Here is a case which exemplifies how much basis there is for the belief in the recuperative powers of capitalism. For Government did

next to nothing beyond permitting, at the height of the financial strain, the issue of one-pound and two-pound notes by the Bank of England. Although the masses did not suffer in silence and their riots, if nothing else, should have been sufficient motive for public action, things were allowed to take their course. And business did recover. Losses had to be taken, South American investments to be written off, prices had to find their levels, what was unable to adapt itself had to be eliminated. All this took time. But as soon as it was done, an upward swing set in by itself. It is true that things were nothing like as serious as they are today, but the catastrophe was of the same kind. Two observations force themselves upon us: first, that the inaction of government, however reprehensible on humanitarian grounds, contributed to recovery at least by not hampering it. Second, that adequate relief would not have been beyond the means of England; had it been provided, the darkest hues would have been removed from the picture without interfering with the process of clearing the ground for revival.

## 1873

The year 1873 caught the United States while the country was going through the long process from Civil War inflation to the resumption of

specie payments in 1879. During the period as a whole, prices sagged continuously. There was a temporary stage of rising prices, about a declining trend, on the back of the vigorous wave of activity and prosperity which, interrupted only by mild recessions in 1866–1867 and 1870, came to an end with the breakdown of 1873. What happened in 1866–1867 and 1870 may fairly be compared with the events of 1924 and 1927; while 1873 and the four years of depression which followed display similarities to 1929 and after. The similarities and the differences are alike illuminating. Both give to the case of 1873 a value almost equal to that of deliberate experiment: Whoever reads the annals of that time becomes conscious of an uncanny feeling to the effect that life itself experiments for us in order to teach us lessons which we nevertheless forget, time after time. Clamor for reckless inflation, for instance, arose at once. An inflation bill was passed by Congress. But President Grant vetoed it (1874). Money eased and prices began to *rise* promptly although slowly.

The center of economic gravity was then in Europe. It was there that the trouble began, and part of the consequences of that world crisis affected this country but indirectly. Everywhere, however, the period 1842–1873 was fundamentally the first railroad age, the age of steam

and steel. The expenditure on railroad building was the backbone of the booms of that time. The new facilities of transportation changed the surface of the economic world and were at the bottom of the necessity of readjustment. We may smile now at the opinion of the age that railroads were being overdone, seeing how small a part of what we now know had to be done was accomplished then. But certainly they were in advance of what was then required. Of course they were, for they themselves created the economic world, which was to provide the demand for their services and which never could have developed without them. They also were the center of reckless finance and malpractice of all sorts. It was the business of railroad construction which produced that mentality, half visionary, half criminal, so well expressed by the saying of one of the railroad magnates of the time—not an American, however—who was indicted when things had gone wrong: "You don't build railroads with moral principles."

Railroads were not the only factor, of course. Incident to their construction and independent of it, there is a long list of other ventures, all of which in some countries were facilitated by the removal of the last remaining shackles by which earlier centuries had fettered enterprise—they were of much the same character as those we

are about to forge afresh today—and by legislation favorable to the emergence of the modern joint stock companies. Those countries, especially Germany and Austria, lived then through their South Sea Bubbles and in this way laid the foundation of their industrial career. With the exception of France, which did not share fully either that prosperity or the breakdown which followed it, the whole world basked in the sunshine of what to some extent really was a new era.

Again it was stock exchange speculation which broke down first. This always is so and accounts for the fact that the public mind so often looks upon it as the cause of the trouble. But it should be obvious that just as the rise of speculation requires another cause to start it, so the downfall of speculation requires a more fundamental explanation than the speculative excess itself. In 1873 this explanation is not difficult to find. It was the slackening down of construction and equipment due to the increasing difficulty of adapting calculation to situations changing with disconcerting speed. This broke prices, called forth unemployment, but first of all created difficulties in the structure of credit and so brought down speculation. Then only, by way of afterthought, people became critical and started out on a revision of values which turned through

the discovery of errors and crimes into a panic outrunning by much the measure of adjustment really required by hard fact.

American speculation collapsed in September, carrying with it, almost immediately, the failure of brokers and many banks. Others had to suspend legal tender payments, to resort to clearing house certificates, and so on. But the monetary system stood firm, the premium on gold touching a new low. It was the market for railroad shares which suffered most, and the speculation in lands which went to pieces most completely. Of course, certain features of the present situation, which are traceable to the World War, were absent then. Apart from them, however, there is *nothing* in what has happened in the capitalist world during the last three years which was not also present in the picture of 1873. Not even the skyscraper trouble of today was absent then; for although there were no skyscrapers, overbuilding, in Vienna, Berlin, Rome, was one of the features of the situation. And again, it is only the failure to provide adequate relief that can be pointed to with confidence as an obvious matter of reproach. All other measures which, this time, were actually taken by the governments of some countries cannot be credited with any remedial effect on the depression, however beneficial they may have been in other respects. Moreover, it

is doubtful whether, given the social and economic structure of industry in 1873, anything really helpful could have been done *after the breakdown*. It would, of course, have been possible to prevent the preceding boom. But this would have strangled also its achievements.

*Four years of stagnation followed.*

### *The Problems of Depression.*

At the threshold of every sensible diagnosis of any given depression lies a fundamental distinction between two different sets of causes and consequences. The reader is welcome to call it pedantic, but without it there is no hope of clear perception of what happens. *First*, as our examples show, business adapts itself to the new state of things created by the preceding prosperity; it reacts on the upheaval due to the intrusion of new and more efficient methods of production and to the dislocation of everyone's profit and loss account. One needs no more than look around in order to grasp this point: The emergence of mass production of cheap cotton goods from the last decades of the eighteenth century onward spelled elimination of many an old shop. The construction of railroads changed the competitive position of localities and opened up undreamt of sources of supply of all kinds of commodities, necessarily supplanting some old

ones. Now we have had combines and dry farming, more efficient methods of producing electricity, rayon and motors and radios, and a thousand similar things. This is really at the bottom of the recurrent troubles of capitalist society. They are but temporary. They are the means to reconstruct each time the economic system on a more efficient plan. But they inflict losses while they last, drive firms into the bankruptcy court, throw people out of employment, before the ground is clear and the way paved for new achievement of the kind which has created modern civilization and made the greatness of this country. It is easy to understand, on the one hand, that all this would happen even if nobody ever made any mistakes and if there were no crooks; but also, on the other hand, that everything that is unsound for either reason shows up when prices break and credit ceases to expand in response to decreased demand for it. Nor is it difficult to see why errors and misbehavior should be abnormally frequent in prosperity. Everyone is a great business man when prices go up, and windfall profits are easily made which obliterate the consequences of errors of judgment and of worse things. When everybody talks of new eras—blissfully unaware of the fact that soon he will be talking of the hopeless failure of capitalism—an increasing volume

of business is being done on the assumption that things will continue to boom. A superstructure of such transactions rises above what is substantially sound and comes down with a crash as soon as, under the impact of the new products or increased quantities of products, readjustment sets in.

But, second, there are the consequences of events of quite a different order. Economic life is constantly acted upon by social and political factors. It lives in a social and political environment full of disturbances of its own. In prosperity and while margins are wide, these influences, though present, are obscured. But they show as soon as things cease to boom. It is manifest, that the maladjustments which resulted from the Napoleonic Wars had much to do with what happened in 1825, that the aftermath of the Civil War and especially of the greenback inflation was an important element in the American situation of 1873. It is equally obvious that in trying to understand any given case we must always bear in mind that what we are faced with is never simply a depression but always a depression *moulded and made worse by forces not inherent to the working of the economic engine as such.*

Now it is of the utmost importance to realize that the only distinctive characteristic of the

present world's crisis, the only thing, that is, which makes it *fundamentally* and not only quantitatively differ from such crises as those of 1825 and 1873, is the fact that non-economic causes play the dominant rôle in its drama. It is not only such consequences of the war as political payments, the annihilation of Russia, and so on, but also other things which make a catastrophe of what without them would have been mere depression: impediments to the working of the gold standard, economic nationalism heaping maladjustments upon maladjustments, a fiscal policy incompatible with the smooth running of industry and trade, a mistaken wage policy, political pressure on the rate of interest, organized resistance to necessary adjustment and the like. It is beside the point to ask, whether this should induce us to reapportion our blame for what has happened between the business and the political world. Nor is it in order for the economist to take melancholy satisfaction in the truth, that present calamities are, contrary to a common opinion, in the nature of a verification of some of the oldest teachings of his science, which have been consistently ignored ever since 1914. What does matter, however, is to realize that *this* is the cause of the impossibility to forecast. As a doctor is unable to predict whether his patient will be run down by a motor car, so

the economist is unable to predict in a situation in which so many political motor cars run about. What we face is not merely the working of capitalism, but of a capitalism which *nations are determined not to allow to function.* This may be, and probably is, inevitable. But it is the great difficulty in the way to recovery.

Hence the problems presented by periods of depression may be grouped as follows:

First, removal of extraeconomic injuries to the economic organism: Mostly impossible on political grounds.

Second, relief: Not only imperative on moral and social grounds, but also an important means to keep up the current of economic life and to steady demand, although no cure for fundamental causes.

Third, remedies: The chief difficulty of which lies in the fact that depressions are not simply evils, which we might attempt to suppress, but—perhaps undesirable—forms of something which has to be done, namely, adjustment to previous economic change. Most of what would be effective in remedying a depression would be equally effective in preventing this adjustment. This is especially true of inflation, which would, if pushed far enough, undoubtedly turn depression into the sham prosperity so familiar from European postwar experience, but which, if it be

carried to that point, would, in the end, lead to a collapse worse than the one it was called in to remedy.

Fourth, reforms of institutions not intended to *remedy* the situation but *suggested* by the moral and economic evils of both booms and depressions: The crucial point of these reforms lies in the coincidence of a political atmosphere exceptionally favorable, and an economic situation exceptionally unfavorable to their success. No doubt they will always be carried amidst enthusiastic clapping of hands. But they will also be stigmatized in future by their tendency to prevent or retard recovery. This should not blind us to any merits they may have, but it is a plain and undeniable fact.

## *The Atmosphere of Periods of Depression*

We have seen that the course of events in all periods of depression presents a significant family likeness. So do the attitudes of people. Defeat on the battlefield destroys the prestige of military rulers and their confidence in themselves; crises destroy whatever of both these things business leaders may enjoy. Their cry for help is the more damaging for them the more they disapproved of government interference before. For the time being, the majority of people grows out of

humor with the economic system under which they live and becomes inclined to favor what in some cases we call reaction and in others radicalism. In fact, it makes astonishingly little difference which way they move politically. The consequences are much the same in both cases.

The readiest attitude to take is to blame individuals, a blame which is undoubtedly only too justified in very many cases. Just as it was, at some times and with some nations, a habit to clamor for the heads of unsuccessful generals, so there was always, and is today, a disposition to punish both culprits and scapegoats in business. English opinion, after the ignominious breakdown of the speculative craze known to history as the South Sea Bubble (1720) seems to have been to the effect that the most desirable measure to take was the hanging of some people. This bent persists. It is more rational that people should insist on measures for regulating and purifying financial practice. The ways of speculation, the responsibilities of promoters and managers, the methods of banking are the chief objects of such legislation. Broadly we may say that while most of these measures, as the historian surveys them, went too far in some respects, and were ineffective in others, and while many of them made immediate recovery more difficult, they have justified themselves on

balance and have succeeded in improving what they were meant to improve.

More important, depression in some cases produces, in other cases materially strengthens, protectionism. People may advocate "self-sufficiency" primarily from non-economic motives. But in prosperity most people realize more vividly what it would cost them; in depression they look upon it as a remedy. It is significant to note that protectionism in England was recalled to life and became a political factor in the prolonged depressions of the eighties but failed to succeed in the boom times that followed. Similarly, English radicalism, although born in the philosopher's closet centuries ago, *emerged* as a power strong enough to count for the politician in the twenties of the nineteenth century, and *established* itself in the eighties. Legislation which Americans would call radical was enacted in the eighties by the conservative governments of Germany and Austria, the first measures of social insurance, for instance, or factory legislation, or restriction of competition, or measures to bridle the rate of technological progress which then took the form of various favors to the small craftsman and so on—some of which lasting achievements, now approved by everyone, others merely due to definite and provable error.

## *The Upshot*

There is no reason to despair—this is the first lesson to be derived from our story. Fundamentally the same thing has happened in the past, and it has—in the only two cases which are comparable with the present one—lasted just as long. We are more keenly alive now to human suffering, and we are dealing with the situation under political pressure by political methods, but substantially we are confronted only with problems which the world was confronted with before.

In *all* cases, not only in the two which we have analyzed, recovery came of itself. There is certainly this much of truth in the talk about the recuperative powers of our industrial system. But this is not all: our analysis leads us to believe that recovery is sound only if it does come of itself. For any revival which is merely due to artificial stimulus leaves part of the work of depressions undone and adds, to an undigested remnant of maladjustment, new maladjustment of its own which has to be liquidated in turn, thus threatening business with another crisis ahead. Particularly, our story provides a *presumption* against remedial measures which work through money and credit. For the trouble is fundamentally *not* with money and credit, and

policies of this class are particularly apt to keep up, and add to, maladjustment, and to produce additional trouble in the future.

Finally, our cases teach unmistakably that, futile as it is to hope for miraculous cures, it is exactly as wrong to believe that the evils of depression are all of them inevitable and that the only sound policy consists in doing nothing. There is no single and simple remedy. The numerous problems which present themselves must be dealt with individually and patiently. The kind of activity which is clamored for in such situations is likely to make matters worse. But all those features of depressions, which spell widespread suffering and needless waste, can yet be taken care of. Especially if a country has steadily improved its public finances during prosperity as the United States did in the decade which preceded the present crisis, enough means are available, and other means can be procured, for an expenditure which will blot out the worst things without injury to the economic organism, *provided only* that action on this line is taken promptly and followed up by equally sound fiscal habits as soon as recovery gets under way.

# PURCHASING POWER

*By* Edward Chamberlin

## *The Problem*

An inadequacy of purchasing power in some sense or other has long been spoken of as a major cause of the depression, and it is only natural, therefore, that the recovery measures should be directed toward remedying this supposed deficiency. Thus the Industrial Recovery Act declares it to be "the policy of Congress . . . to increase the consumption of industrial and agricultural products by increasing purchasing power . . . " and the Agricultural Adjustment Act is "an Act to relieve the existing national emergency by increasing agricultural purchasing power. . . . " The phrase has a technical sound, and any policy receives added sanction by its use provided purchasing power is being *increased.* This in itself gives some ground for suspicion. It is simply too good to be true that purchasing power should always increase or that its increase in the hands of some particular

group should be universally benevolent. Let us try to arrive at a few common sense conclusions as to the nature of purchasing power and its relation to recovery.

Purchasing power is a useful term to the technical economist, but if we are going to follow common sense we may as well start out by recognizing that a person's purchasing power is very simply his income, and that false implications may often be avoided by calling it that. The question of whether the worker, the farmer, or the business man should have their incomes increased has quite a different flavor from that of whether they should have their purchasing power increased, and all this is a net gain for clear thinking at the outset.

We most naturally think of our incomes in terms of money. But a much more significant way to think of them is in terms of the goods and services which we buy with our money incomes. This we may call our "real" incomes, and it is obvious at once that it is these which really matter. An increase in money incomes is of no advantage if counteracted by a corresponding increase in the prices of the things we buy. But it is likewise of no disadvantage, and so we might conclude that if all prices and incomes moved up and down together it would be a matter of complete indifference whether the price level

were high or low. In fact, however, changes in the price level may be disastrous for the very reason that all prices and incomes do not go up and down together. In particular, debt agreements are contracts which may extend over long periods, so that if prices and incomes fall the debtor is left to make the same money payments out of a diminished money income. The creditor, of course, makes a corresponding gain. Similarly, the long-time creditor loses, to the benefit of the debtor, in a period of rising prices. Furthermore, certain incomes do not adjust themselves readily in a period of general change. Wage and salary receivers lose in a period of rising prices because their money incomes tend to lag behind: their real incomes are thereby reduced while those of their employers are increased. It must be obvious that an increase in *money* "purchasing power" does no more than to exploit one class at the expense of another, unless it is accompanied by an increase in *goods* "purchasing power," or production. Such "exploitation" may be justified, however, if it serves, even in part, to cancel out a counterexploitation in the recent past. It is on this ground that a case can be made for raising average prices and incomes to the 1926 level, *provided* only that the rise could be controlled and stopped at this point. The difficulties involved in this set of problems are reserved for

later discussion in the essay on "Higher Prices."

Let us, then, turn our attention to real incomes. The problem is that of increasing "purchasing power" in the sense of increasing the production of goods and services; of reëmploying idle workers, idle factories, and idle business ability, so that standards of living can be raised from their depression levels. Such an increase is obviously not a means of bringing about recovery; it is recovery itself. What we have to do is to consider the effectiveness of other means with reference to this end.

## *The Will to Spend*

A great deal has been said and written about the importance of "spending." It is obvious that the available supply of money and bank credit has been used very slowly during the depression. Billions have been hoarded and not used at all. Other billions have lain idle in the form of bank deposits, turned over at much less than their usual rate. Could not something be done to put this money into more rapid circulation?

The results of such a policy may first be examined. To the extent that increased spending can be brought about it will either raise prices or expand business activity, or both. An expansion

of business (or using up of accumulated stocks) proportional to the increased spending would obviously leave prices exactly where they were. In fact, a rise in prices is an index of the extent to which the revival of business has fallen short of the revival in spending. Dollars are buying less, and those whose money incomes have not changed have less real purchasing power than before. As for those newly employed, the rise in prices indicates that goods are not being produced for their consumption. They get a share of the available supply only because the consumption of others is diminished. It has just been pointed out that a case can be made, with restrictions, for a limited rise in prices. Beyond this the legitimate aim of increasing money purchasing power is clearly to increase "real" incomes, that is, the goods available for exchange and consumption. This aspect of the matter must be constantly held in mind.

What, now, of specific measures? "Buy now" movements run the danger implied in the "now": if one buys now he may be unable or unwilling to buy later. To the extent that purchases are moved forward and grouped at a certain period the result may be only to create a short-lived boom, as in the summer of 1933, followed by a corresponding slump in the period when the buying would normally have taken place. Yet if

people are persuaded not to *diminish* their purchasing, this is something. And there is always the possibility that a movement once started will spread, thus creating new employment and production which will be retained.

The same can be said if the government "buys now" by spending money on public works, and there is even less danger here of a possible slump when the buying has stopped. Such government spending could, barring the difficulties of practical politics, be so distributed through time that it would taper off as business revives. Obviously it should be financed in such a way as not to diminish current spending elsewhere. The best method is probably through the issue of bonds to be taken up by idle banking and investment funds and retired by taxes levied in the next period of "prosperity." Aside from questions of political intrigue and corruption, it may be said against public works that nothing is being produced to raise current standards of living. Bridges, roads and public buildings may ultimately be useful, but the workers who are producing them will spend their money incomes on food and clothing. Other workers will in time be employed in providing them with these things, but there is a danger of creating for a period an artificial boom in the retail trades and in industries close to the consumer, a boom

which will mean reduced consumption on the part of everyone else (through higher prices) for the benefit of the workers employed on public works. Direct relief measures are subject to the same objection that, since nothing is being produced, there is simply a redistribution of the available supply. To the extent that it is made possible for those in need of relief to produce the commodities they consume or to produce other goods which may be exchanged for them, there is an increase in real purchasing power and no drain on the incomes of those already employed. Unfortunately such a program is not easy to devise.

As to increasing the will to spend on the part of business men and private individuals who have the money purchasing power and refuse to use it, it is unfortunately true that spending is as much a result of recovery as a cause. Business men who see no profits ahead are not apt to employ more workers and expand production. Workers who are uncertain about their jobs are very apt to hoard cash and counteract the efforts to increase spending elsewhere. Money circulates slowly in a depression because there is a diminished amount of money work to be done. The government can spend itself to make up for the fact that other people do not, but so long as it does not become the sole employer by taking over all industry it

must of necessity rely for recovery mainly upon creating the conditions which will make it profitable for private business men to spend.

## *Is Consumer Purchasing Power Peculiarly Significant?*

We pass now to the question of the supposedly strategic position occupied by that part of total purchasing power which is in the hands of consumers. The great advance in technical methods since the war has popularized the argument that the consumer's purchasing power is chronically deficient. Modern industry, we are told, produces goods in such abundance that those who would consume them lack the wherewithall to take them from the market. "Mass production demands mass consumption; mass consumption demands mass buying power," and the flaw in the capitalistic system is that it fails to make provision for this buying power. The argument is most often related to the thesis that it is high *wages* which are the key to prosperity. This we leave aside for the moment in order to center attention upon the more general thesis that is high consuming power, in no matter whose hands it is found.

In the first place, we are very apt, unless we guard against it, to get into a careless way of identifying the consumer's part with the whole of

purchasing power, especially since the contrast, in popular usage, between spending and saving implies that what is saved is not spent. Yet a moment's reflection will reveal that money performs the same rôle in saving that it does in the exchange of goods—it is the *medium.* People save "money," but they do not ordinarily put the money to one side, that is, withdraw it from circulation. They invest it, either directly through purchasing securities, mortgages, and the like, or indirectly through depositing it in a savings account with some bank, which, in turn, must invest it in order to earn the interest it pays. The money goes back into circulation again: it has been "spent" on factories, machinery, stocks of merchandise or supplies—whatever the borrowing business man or corporation has used it for. A large part of the total saving is done by corporations themselves, who reinvest earnings in their properties instead of declaring them out as dividends. All such money investments are spent as truly as money laid out upon sugar and clothing is spent. And they are just as effective in employing labor. This very simple fact has been almost, if not completely, overlooked in the very great preoccupation of the recovery program with increasing the consumer's buying power. The truth is that, in the current depression, in spite of unemployment,

purchases of consumer's goods have fallen off much less than have investments (purchases of capital goods). Only when the "heavy" industries showed a tendency to lag behind in the midsummer revival of 1933 was it generally remarked that something must be done for these industries as well as for those turning out consumer's goods directly.

A policy of favoring consumption over against investment merely gives jobs to those workers who are employed in the retail trades and in manufacturing industries near the consumer, while denying them to workers in the "heavy" capital-producing industries where invested money is spent. In fact, since either set of workers will probably spend its income on consumption goods, there is an *identical* addition to the money purchasing power in the hands of consumers in the two cases. In the case of investment, there is no immediate addition to consumable goods, however, since factories and machinery are not immediately consumable. This raises the possibility, already discussed in connection with public works, of the prices of food and clothing rising on account of an increase in *money* purchasing power in the hands of consumers before there can be a corresponding increase in production. From this point of view, there are sound reasons not to invest too large a

part of the national income at the present time. Four years of depression have made us so poor that we cannot afford to devote too much of our energies to remote ends. As recovery will take place gradually, however, there is little reason to suppose that this adjustment will not be made naturally without any artificial discrimination against workers in the heavy industries.

Let us turn now to the thesis that it is deficient consumer purchasing power which brings on depressions. A sweeping advance in technology such as took place in the postwar decade would naturally be expected to make consumer's goods more abundant and hence to lower their prices. It is this fall in prices which, so the argument goes, makes it impossible for the goods to be sold at a profit, and hence, by forcing curtailment of output and the discharge of workers, sets into motion the forces leading to depression. Technological improvements, however, are synonymous with lower costs. Granted that prices fall, it follows from the argument only that they fall in proportion to the reduction in costs, and therefore producers do not make losses on this account. Incomes remaining the same (and there is no reason why they should change) the fall in prices is a necessary and wholly desirable consequence of more efficient production whereby benefits of progress are passed on to the con-

suming public. Goods purchasing power is already increased by the fall in prices, and this should suffice to take the goods from the market. An increase in money purchasing power, supposing it to produce a corresponding increase in prices, would only leave real purchasing power exactly where it was before. A fall in the prices of consumer's goods, then, which is the key to the underconsumption argument, does not necessarily indicate that purchasing power has been wrongfully diverted from consumption to investment. It is quite to be expected, of course, that too much will be invested in *particular industries* and that profits will fall in these industries as a part of the natural corrective forces in the system. Increasing consumer purchasing power will not, nor should it, prevent the fall of profits in those sections of industry where overexpansion has taken place.

It has been argued by some writers that purchasing power should be put into the hands of consumers rather than savers because of the slow rate of turnover of money which is saved. It is undoubtedly true that, especially in time of depression, sums which are taken from income and saved may lie idle in banks without being invested, or spent. The trouble is, however, that the same is true of funds which are not saved. Income destined to be spent on consumer's

goods is likely to be spent slowly when there is uncertainty as to the future. Furthermore, people do not fall neatly into the two classes of consumers and savers. The worker is dominantly a consumer, but it is nevertheless true that he may deposit a part of his income in a savings account and that he may spend very slowly that part of his income which is destined for consumption. We conclude that there is very little if anything to be said for the consumer's purchasing power having any preference over the investor's.

### *High Wages and Prosperity*

The theory that high wages create prosperity has been loudly proclaimed over the last decade. Support for it is derived mainly by reference to the supposed deficiency of consuming power, since wage earners are predominantly consumers. Yet there is far from being an identity between the worker and the consumer. Farmers, salary receivers, interest and dividend receivers, as well as wage receivers, are consumers. Wage receivers, moreover, in normal times, save a portion of their incomes and may be expected again to accumulate reserve savings as conditions improve. Labor is only a part of the whole body of consumers and is only in part a consumer.

The most obvious error in the high wage theory, however, is its tacit assumption that a high wage *rate* is identical with a high total volume of purchasing power in the hands of labor. Clearly it is only to the latter that any importance could possibly attach as far as "maintaining prosperity" is concerned. The total spending power of labor is the product of the average wage rate multiplied by the number of laborers employed. High wages accompanied by a large volume of unemployment mean a reduction rather than an increase in this total.

Employment, of course, is influenced by many other factors besides wages. But there is no denying that wages are a factor, and an important one. So much has been written about the substitution of machinery for labor in the postwar decade that it must be evident that there are many phases of production for which either labor or machinery may be used depending upon which is the least expensive. There is no doubt that the tendency to substitute machinery for labor is strengthened by artificially high wages. This is true for any given set of technological possibilities. It is likewise true that the discovery of new technological possibilities is stimulated by high wages which put a premium on the discovery of labor-saving devices. It thus appears that a rate of wages which is too high may work posi-

tive injury to the class it is supposed to benefit by forcing an undesirable mechanization of industry and holding more or less permanently out of work a large portion of the working population.

There is no doubt as to the positive injury to *other* classes by such a policy. Let us not be deceived by the specious argument that those workers who are employed can purchase more. Higher wages raise costs and therefore prices, with the result that other people can purchase less. Those who are unemployed can purchase nothing at all, except as purchasing power is put into their hands by taking it away from others. To have a considerable portion of the labor resources of the country idle is, in itself, a waste which seriously reduces the total national income and thereby the real incomes of everyone (except, of course, the workers who are receiving the high wages).

Surely it is much more important to reemploy workers who have no income than to increase the incomes of those who already have jobs. It is perfectly true, of course, that with recovery both ends will normally be achieved. But this is because a single cause, the increased demand for labor, has had a twofold effect. It remains true that higher wages while millions are still unemployed act as a brake on their reëmployment.

And they act as a brake on recovery generally by increasing costs at a time when industry is struggling desperately to make both ends meet and needs encouragement.

It is only natural that the theory should have the strong support of organized labor. Any other group, say lawyers, or doctors, could argue with equal validity that the way to bring about prosperity was to increase the purchasing power of that group. When we recall that "incomes" may be substituted for "purchasing power," the case loses much of its appeal. What is lost sight of is that the privilege of exercising purchasing power confers a corresponding benefit on the person who exercises it, whereas it is of no peculiar benefit to the rest of society that he, rather than someone else, has been given the privilege.

# CONTROLLING INDUSTRY

*By* Edward S. Mason

The goal of increased purchasing power, sought in the Recovery Act, means an increase in wage costs. Although the spokesmen of the New Deal have minimized this aspect of the matter, they have not denied it. The business man, however, battered by four years of depression is to be compensated. Increased purchasing power is supposed to guarantee him an increased output and a consequent reduction of his overhead. In addition, he may look forward to a relaxation of the anti-trust laws, to the elimination of cut-throat competition and other unfair practices and to the legalization of agreements for the orderly production and marketing of his goods.

The elusiveness of the purchasing power mirage has been pointed out in a previous essay. Let us turn now to other aspects of the new cooperation between government and industry. For years American business has supposedly groaned under the incubus of the anti-trust laws. These

laws, it must be remembered, have not interfered notably with the formation and growth of large-scale enterprise. The United States Steel Corporation, the International Harvester Company and the Aluminum Company of America, all "good trusts," certified as such by the proper authorities, bear witness to this fact. On the other hand, the anti-trust policy *has* hampered agreements for price fixing and proration of output. The Federal Trade Commission and the courts have not cooperated any too happily or effectively in the elimination of unfair business practices. Cut-throat competition, at least in the business man's sense of the term, has flourished.

These phenomena have affected deeply the attitudes and aims of business men. Long before the term New Deal achieved political significance, the United States Chamber of Commerce, the National Association of Manufacturers and other bodies representative of economic enterprise had gone on record in favor of a relaxation of the laws against agreements in restraint of trade. The promise of such a relaxation was enough to awaken a happy response in American business. It was the bait calculated to make wage increases more palatable to employers of labor. As such it was a politically necessary segment of the National Industrial Recovery Act.

Strangely enough, business interests in their attack upon the anti-trust laws never appeared to consider that freedom to make agreements for regulation of output and price might carry with it a form of governmental control even more restrictive than those same anti-trust laws they were trying to escape. Yet it was hardly conceivable that American public opinion, fed for decades on the fear of monopoly and monopolistic extortion, would permit such agreements without governmental supervision. Nor is it conducive to the public interest or, indeed, to the interest of business enterprise itself that agreements of this sort be permitted. Nevertheless, in the various schemes for industrial cooperation and planning sponsored by the Chamber of Commerce, by Swope and others—plans which had their influence on the formulation of the Recovery Act—no adequate supervision was contemplated. Government was to enforce business agreements entered into for the purpose of regulating output, investment, conditions of competition and prices, but the terms of the agreements were to be left to enlightened economic enterprise. The role of government in the N. R. A. may yet be subordinated to business. But hardly without eventual reactions extremely disturbing to an individualist economic order.

* * * *

It may be seen then that this part of the recovery program dealing with business agreements and codes of fair competition has a history antedating the depression. It is likely, moreover, to have consequences which outlast recovery. Once set up, these codes and agreements may well have established vested interests extremely difficult to dislodge. Our economic history is not lacking in examples of how the interests of particular producers may triumph over the commonweal. The Recovery Act gives promise of bringing this history up to date. These eventualities cannot be entirely separated from a consideration of the immediate consequences of the Act. Nevertheless, our problem is recovery, and the program of codes and agreements must be considered primarily in its bearing upon recovery.

Administration spokesmen apparently consider the program of codes and agreements strong recovery medicine. "We are now seeking," says General Counsel Richberg, "to bring about a purposeful, planned organization of trades and industries, so integrated and coordinated that the continuous production and exchange of necessary goods and services may be assured." The individualistic, disorganized and anarchic striving for profits, which, according to this school of thought, can only lead us deeper into depression, is to be replaced by a

united and determined business effort guided but not "regimented" by government. The President, in concluding his statement on the signing of the Recovery Act, asks a question which perfectly reflects the spirit of the measure. "Must we go on in many groping, disorganized, separate units to defeat or shall we move as one great team to victory?"

There is no denying that the words and phrases which spring to the defense of the Recovery Act have a strong appeal. "A cooperative effort," a "planned," a "coordinated," an "integrated," an "organized" attempt to handle the problems of production and exchange. It only remains to compare the benevolent and vague conotation of these terms with the actual and probable consequences of the policy which the Act and its administration have initiated. It will be convenient to examine the program under the following headings: (1) as a means of eliminating unfair competition; (2) as a scheme for regulating output and prices; (3) as a substitution of planning for unregulated individualism.

## *Unfair Competition*

Unfair competition is a term which covers a large number of business practices of long standing in American industrial life. It is, or should be, a term of fairly definite meaning, referring

to those practices of business firms which tend to prevent the establishment and survival of the most efficient type of enterprise. Very frequently these practices have little or nothing to do with competition in the ordinary sense of that term. Undoubtedly one of the strongest motives underlying the American anti-trust policy was the desire to eliminate unfair competition. In a "fair field with no favor" it was thought the most efficient enterprises would tend to survive to the great advantage of the public interest. Certain practices held to be unfair were specifically mentioned in the anti-trust laws. Others, and a far larger number, have gradually been defined in the process of judicial interpretation.

Nevertheless, unfair competition, despite the anti-trust laws, the Federal Trade Commission and the courts, has not been eliminated. Frequently, no doubt, the ruthless and unprincipled firm has won out against the more efficient. Even more frequently the ruthlessness and lack of principle of a few firms have dragged down the business standards of others, compelled to copy these practices in order to survive.

It is not too difficult a task to discern the principal reasons for the continued existence of unfair competitive practices in American business life. Constitutional guarantees against governmental interference with property rights and

freedom of contract, interpreted by conservative courts, have, up till now, successfully withstood administrative attacks upon certain of these practices. The Federal Trade Commission, the principal governmental body responsible for the administration of laws against unfair competition, badly directed at times, has lost prestige heavily by reason of frequent setbacks in the courts. Finally, American business has not, until recently, shown itself particularly willing to lend that cooperation which is necessary to a successful front against unfair practices. In fact, there is more than a little reason for believing that criminal assaults on competitors and their places of business have frequently been tolerated by business groups anxious to maintain an established practice. This is nothing less than the annihilation of competition.

Four years of depression, as might be expected, have intensified competitive methods of all sorts, fair and unfair. The ethics of business practice have steadily deteriorated. Reputable firms have found themselves compelled to adopt the methods of disreputable competitors. Those who have put common decency before profits have been forced to suffer. As a result American business finds itself more ready to make a concentrated effort against unfair practices than ever before. Other impediments to their elimi-

nation are likewise of lessened importance. The constitutional guarantees of personal and property rights remain but, as Mr. Dooly long ago remarked, the courts have been known to listen to the election returns. And of late the election returns have appeared strongly to favor an accession of executive power. The Federal Trade Commission and the N.R.A. are likely to have smoother sailing in whatever actions they may bring in the courts against unfair competitive practices.

* * * *

The codes of fair competition which are rapidly emerging from the cooperation of government and industry have already shown how far it is proposed to go in dealing with the great number and variety of dubious business practices. Some forty or fifty separate practices have been officially condemned ranging in seriousness and importance from the "blowing" of oysters in order to increase their weight to personal price discrimination and the repudiation of contracts.

This long catalogue of competitive methods invites a number of comments. Certain of the practices are mentioned in almost all the codes. Others are local and of little significance. Probably the most important is cut-throat competition defined and condemned in many of the codes as sale below cost. The notoriety of this

method of competition and the relation of its treatment in the codes to the problem of price fixing necessitates special consideration in the following section.

Other practices, while no doubt justly condemned, are difficult to eliminate even under the most favorable circumstances. Among these may be mentioned the splitting of commissions and the lavish entertainment of intended customers. For a limited period and in particular cases, enthusiasm for the ideals of the N. I. R. A. may check these abuses. But the check is by the nature of the offense mainly to be applied personally. Abuses are nearly impossible to ferret out and punish without an intolerable system of espionage, the cost and inconvenience of which must be set against its possible success.

Practices condemned in some codes, on the other hand, appear to be merely variants of ordinary price or quality competition in no sense reprehensible or contrary to the public interest. The use of trading stamps, the granting of "excessive" discounts (as long as they are granted openly and equally to all customers) and the giving of guarantees against price declines seem to belong in this class. It is only if we assume that ordinary price and quality competition, matters to be discussed in the next section,

is uneconomic that these methods can be condemned.

Still other practices condemned by the codes have long been recognized by the courts as illegal. Against them adequate protection already exists. It is not likely that through action by the N. R. A. the defense against imitation of competitors' trademarks, misbranding and similar admittedly illegal practices will be materially strengthened.

Nevertheless, when all these reservations and qualifications are taken into account, the Recovery Act represents a long step toward the recognition and condemnation of unfair and uneconomic competitive practices. It represents a still longer step toward the securing of business cooperation in their elimination. Especially hopeful is the prospect of curtailing appreciably the curse of racketeering in American business life. These steps together with the child labor and minimum wage policy constitute, in my opinion, not only the most important but the sole justification of the Recovery Act, apart from its public works provisions.

An observer of the slow and halting development of economic institutions may be permitted, however, a certain pessimism with respect to the importance and duration of this advance. The

elimination of unfair competition is not likely to constitute an important step toward recovery. Its real importance lies in what the President calls the "long pull." But the new attitude of business towards unfair competitive practices is largely the product of depression. It may possibly not outlast recovery. If the enforcement of the numerous provisions of the codes must depend upon the activities of a large bureaucracy of snoopers, the advance is more than doubtful.

### *Regulation of Prices and Output*

Wage increases enforced by the N. R. A. tend to make prices higher. There are two other ways by which the government-sanctioned agreements between competitors may lead to high prices. Both involve necessarily a restriction of output. By the first method the prices of a product are set at levels below which it is declared illegal to sell. Since the prices set exceed those which would rule in the market were it not for the codes, a restriction of output is imposed on the producers. The second method restricts output directly by various means allowing prices to find whatever levels the new supply conditions determine.

To be sure, there is nothing in the National Industrial Recovery Act itself, apart from the special provisions concerning the oil industry, which can be clearly interpreted to permit

agreements for price fixing or limitation of output. In fact, it is expressly stated in the Act that the industrial codes shall not "permit monopolies or monopolistic practices." It only remains to be seen whether certain terms of the codes already accepted by the Administration do not permit, even encourage, those very practices of a monopolistic character which the law appears to forbid.

Any code provision which imposes an effective limitation on the number of machine hours which may be worked in a plant certainly constitutes a definite limitation of output. Yet a number of codes have these provisions. The wool textile code, for example, provides that "no employer shall operate any comb or any spinning spindle or any loom or any knitting machine for more than two shifts of forty hours each per week." Such a provision in this and the other textile codes cannot at present be considered serious. It merely introduces a desirable piece of labor legislation eliminating the midnight or graveyard shift. In all these codes, however, is also the provision that the number of machine hours may be further reduced when the code authority and the administrator agree that it is in the interest of the industry and the public. Already the cotton textile industry has taken advantage of this opportunity and has

secured the consent of the administrator to a 25 per cent reduction in machine hours.

The limitation of machine hours imposes a very effective proration of output among the different producers based on installed machine equipment. The code for the lumber and timber products industry goes further and assigns to the various producers definite production quotas. Yet it is expressly stated that this code "shall not be construed, interpreted or applied so as to promote or permit monopolies or monopolistic practices, and shall not be availed of for that purpose."

Restriction and proration of output, whatever the law or the codes may say, is a monopolistic practice designed to raise prices. It is a practice outside the capacity of a number of firms acting independently and becomes possible only when these firms combine. The fact that the government stands behind the combination and enforces the terms of its agreement only serves to make it the more effective.

In addition to devices for raising prices by restriction of output, a large number of the codes provide for the setting of prices which can have no other effect, if applied, than the restriction of output. The lumber and timber and the bituminous coal codes prohibit sales at less than minimum prices. This result may be at

least partially accomplished through provisions in other codes making illegal sale at less than cost. The shipbuilding and ship-repairing code, for example, declares it to be an unfair method of competition "to sell any product or service below the reasonable cost of such product or service.

"For this purpose, cost is defined as the cost of direct labor plus the cost of materials plus an adequate amount of overhead including an amount for the use of any plant facilities employed."

The electrical manufacturing code has a similar provision. In fact, they are common in the codes thus far adopted. By means of these provisions is outlawed that bugaboo of American business the price cutter and his practice, cut-throat competition.

We may proceed now to a consideration of the effect and meaning of these various code provisions.

By cut-throat competition business men mean oftentimes nothing more alarming than the selling of competing products at prices less than their own. This practice, however, is neither dangerous nor to be condemned. Much more serious is the occasional attempt of a large-scale enterprise selling in many markets to wipe out local competition by sales below cost in a single

market, recouping the losses by profits elsewhere. This is a well-known type of unfair competition universally and justly condemned. The cut-throat competition which appears to be contemplated by the codes, however, is something different from either of these practices. It is sale at prices too low to cover full costs including overhead. Such sales are not necessarily either predatory or at prices below those of competitors.

Most people, I am sure, will be apt to see nothing wrong in a code provision which outlaws sales below cost. Why shouldn't costs be covered? Normally or ordinarily they not only should be but are. The difficulty lies in the situation in which we find ourselves here and now. While we are struggling to recover from a depression which has already carried us to somewhere near half of the volume of output of 1929, the setting of prices necessary to cover in full overhead costs would only lead to a further and disastrous shrinkage of output.

Why this is so can easily be understood if we look for a moment at the nature of this thing called overhead costs. They are costs of plant and equipment which cannot be easily adapted to changes in the volume of output. In ordinary times when output is normal and there is little or no unused capacity, overhead costs are

covered without difficulty at a price which does not curtail demand. When, however, demand falls off and output has to be reduced, the overhead costs, which cannot be reduced, become heavier per unit of the lessened output. To attempt to cover these costs by raising the price of the product is simply to curtail demand still further, and there may easily ensue a vicious circle of increased prices and reduced demand.

Yet it is precisely such a vicious circle that the code provisions against sale at less than total cost may set up if they are effective. Producers in a single industry, particularly if they are producing an indispensable commodity, might, by raising the price of their product, increase their net profits even though output was slightly diminished. But if the producers in all industries attempt to cover their overhead costs, already abnormally high because of reduced output, by raising prices, the result can only be a widespread further restriction of output. The public will have less goods and producers will have less profit.

Despite the condemnation of monopoly and monopolistic practices then, the Recovery Act as interpreted by various codes of fair competition permits government-sanctioned and government-enforced agreements between competitors for

limitation of output and prices. The attack upon competition represented by code provisions limiting machine hours, prorating output, prohibiting sales below costs and the adoption of superior techniques of production is really an attack upon consumers. These methods can only result in a smaller national income and consequently a smaller income per person. For a chronically depressed trade such as the bituminous coal industry, they may offer relief to producers and are, perhaps, justified. To attempt a similar relief for all industries, because they are all at present depressed, is to give relief to none. Far from being a step forward toward an orderly system of production, such methods are a throwback curiously reminiscent of the middle ages. They put industry in a strait-jacket hampering not only recovery but future economic progress. Governmental connivance in these practices, moreover, opens up distressing possibilities of private gain at the expense of the public interest through political influence and intrigue.

Just how serious a check to recovery the code agreements are apt to be it is difficult to say. In forming some estimate of their importance it is necessary to bear in mind a number of considerations. First, agreements, or at least tacit understandings between producers in various industries,

to maintain or raise prices by restricting output were not invented by the Recovery Act. Despite the existence of anti-trust laws they have been an important feature of American economic life for many decades. Undoubtedly price controls of this sort have already seriously hampered recovery. They have tended to prevent an adjustment of the prices of various materials and types of capital equipment to the new economic situation created by the depression, an adjustment without which an industrial upswing is difficult. In so far as the N. I. R. A. merely brings these hidden agreements and understandings into the open, it does no further harm to recovery.

Second, the provisions written into many of the codes for regulation of output and the raising of prices may prove difficult or impossible to enforce. We lack the body of trained and impartial public servants necessary for this task. In so far as regulation is ineffective, these provisions will not effectively hamper recovery. On the other hand, they tend to make evasion habitual and to further that disrespect for law of which the Prohibition amendment provided so unfortunate an example.

Third, when these considerations have been duly allowed for, it seems obvious that many industries immune up to now from monopolistic price fixing and limitation of output have been

inoculated with this virus by the N. I. R. A. To the extent that producers in these industries, acting through the codes, raise prices by limiting output, recovery is measurably checked.

It is greatly to be feared, moreover, that these evils may outlast recovery. Although the anti-trust laws are still declared to be in force, an entirely new attitude toward agreements in restraint of trade is evident in administrative circles and may soon be embodied in court decisions. Agreements of this sort should never be tolerated unless a technique and a machinery of government regulation is available for their control. So far very little progress has been made in this direction.

## *Planning*

Nothing in the terms of the National Industrial Recovery Act itself justifies us in the conclusion that what is contemplated is an important step in the direction of a planned economy. Other evidence, however, points clearly toward this objective. The language used in explanation and defense of the measure by its spokesmen, from the President down, is the language of planning. Rugged individualism is castigated, laissez-faire is denounced as the author of all our woes, a "chiseler" has become the symbol of the old order in which individual insubordination pre-

vented any concerted effort for recovery. Under the New Deal, production is to be "adjusted" to demand; investment is to be "adapted" to the needs of industry; purchasing power is to be "allocated" to the various groups of consumers in such fashion as to secure a "balanced" and "orderly" economic process.

It is to be noted, moreover, that machinery set up by the codes may be available—perhaps is meant to be available—for furthering this end. Almost every code authority has a planning committee whose function is the collection of the data necessary to the regulation of supply to demand. A planning commission in the N. R. A. has at its disposal the information wherewith to fit the claims and demands of particular code authorities into a balanced plan for the whole economy.

It is true that so far not much in the direction of economic planning has been attempted. Such adjustments of output and prices as will (in the familiar code formula) "tend to preserve a balance of productive activity with consumption requirements" have been as yet tentative and may be unenforceable. It is true that in the cotton textile and some other codes there is a provision prohibiting the investment of new capital without permit from the administrator of the Recovery Act. This is a

very important piece of economic planning indeed, involving governmental direction of the allocation of capital funds. But to date it is important chiefly as an indication of the direction in which the Recovery Act may evolve.

An examination, however, of the public statements and writings of certain officials high in administration councils leaves no doubt that a strong group of Presidential advisors has the ideal of a planned economy close at heart and sees in the National Industrial Recovery Act the proper instrumentality to achieve that end.

Before we irrevocably embark upon this policy it may be well to consider some of the difficulties involved. To go only as far toward economic planning as the Recovery Administration now appears to be willing to go, it is necessary to have the answers to two questions: (1) When is the output of a commodity "adjusted" to the demand? (2) When is the investment of capital in an industry "adapted" to its needs?

A perusal of the codes seems to indicate that the answer to the first question favored by the Recovery administration is that output is adjusted to demand when the full costs of production including a fair return on capital

invested is covered by the price of the product. It is doubtful at the present time whether more than a small proportion of the output in most industries is sold at a price which will cover these costs. A rigorous application of this policy would immediately drive out of business large groups of producers in every industry, would raise the price of all products, and seriously curtail the demands for these products.

Of course, such a policy cannot and will not be put into practice. The absurdity of it is evident. But can we by this or any other criterion provide for a proper adjustment of supply to demand? The answer is no. The statistical data necessary to such a decision are not available nor are they likely ever to be available to the planning committee of the N. R. A. or to any other committee. Consumer demand is in constant process of shifting from one commodity to another. Certain industries are declining, others are growing and still others are yet unborn. To attempt to arrest the decline of the first by setting prices sufficient to cover costs would be suicidal. To limit the price of the products of the second would only arrest their normal growth. And the dead hand of the government resting on the price and output policies of all industries would prevent the third

group, new or nascent industries, from coming into being at all.

The second question, When is the investment of capital in an industry adapted to its needs? is just as difficult to answer as the first. Consider what happened during the Coolidge-Hoover boom period. There occurred in these years a gigantic misapplication of capital resources. We see clearly now that this was so. It was not so clear before 1929, however, even to astute observers. In part the mistakes were the result of our investment machinery. Some of them can be at least partially guarded against by a reconstruction of this machinery. But to supplant individual initiative and responsibility in the investment of capital resources by government decision, as is contemplated in certain of the N.R.A. codes, goes far beyond any justifiable reform of the investment machinery.

As long as individual decision is relied upon for the investment of capital funds, mistakes will be made, losses incurred; excess capacity will crop up in certain industries, excess profits in others. The primary cause of these mistakes, far and away more important than any other, is the fact that the plant and equipment in which so large a part of investments are made has a long life expectancy. Investment in fixed resources take place upon anticipations of

future demands. But between anticipation and realization many years elapse during which the currents of trade and industry shift.

Is it reasonable to suppose that a government bureau will be apt to make a sounder guess on the future currents of trade than the individual or institutional investor? No amount of statistical data assembled by a planning commission is proof against the possibility of error. If the government does take upon itself the responsibility of directing the flow of capital resources, what happens when a mistake is made? Does the government guarantee the investor against loss?

It is highly improbable that the code provisions concerning the investment of new funds in particular industries will be transformed into a thoroughgoing government control of the direction of capital resources. Nevertheless, they constitute a step toward this goal. Administrative councils, moreover, are not devoid of representatives who apparently relish this prospect. What N. I. R. A. may possibly become is as potent a source of alarm as the damage it is at present doing to recovery.

## *Conclusion*

The National Industrial Recovery Act, exclusive of its labor and public works sections,

proposes a thoroughgoing revolution of our anti-trust policy. As a means of dealing with some methods of unfair competition the codes offer possibilities.

But certain code provisions also constitute a distinct menace not only to recovery but to reform. The provisions for limitation of output and the raising of prices, if effective, can result only in the further curtailment of our already seriously reduced national income. The power to administer these provisions has not yet been clearly allocated. It may well come to rest in the hands of the trade associations or some other representative of an exclusive business interest. In this case the codes would serve as the foundation of a cartel type of organization exercising a monopolistic control over price and production. But the public would then be deprived of the benefits of that competition of outside firms which has made the cartel régime in Germany tolerable, for, if the codes live up to their intention, no firm will be left outside their scope.

On the other hand, the power to administer the codes may come to rest in a government department or bureau. In this case we must be prepared to see an enormous expansion of a bureaucratic machinery whose elaborate espionage will make the machinations of the Federal

Trade Commission in its most meddlesome mood look mild. To date, moreover, principles or criteria in accordance with which government officials may effectively adjust supply to demand or determine what price is proper have not been vouchsafed.

Outside certain more or less tentative code provisions for limitation of output, raising prices, and restricting investment, not much has yet been done in the direction of economic planning under the Recovery Act. But more is promised. It may be ventured, however, that before we go far along the road toward a planned economy a more thoroughgoing demolition and reconstruction of our system even than that contemplated by the sponsors of the Recovery Act will have to be undertaken.

# HELPING LABOR

*By* Douglass V. Brown

In a real sense, all of the factors affecting recovery may be said to have a bearing upon the welfare of the worker. Anything which helps to bring about a return of better general economic conditions will make possible better conditions of labor. Certain measures, however, have been proposed or put into effect which aim more directly at improving the lot of the wage earner, and it is to a consideration of such measures that this essay will be devoted.

Broadly speaking, measures designed to improve directly the conditions of labor may be classified into three groups, according to their primary purpose or effect. There are, in the first place, steps to relieve those who are at the moment unemployed. Second, there are programs which have as their aim an increase in the numbers employed. Finally, there are measures primarily concerned with the betterment of the wages or working conditions of those who are actually in employment.

While it will be convenient to follow this classification in the following discussion, a word of caution is necessary. Whatever the primary aim of a particular measure, it will be found to have repercussions that act, favorably or unfavorably, upon the success of other parts of the program. The financial drain of expenditures for public works, for example, may be so great as to render an adequate program of relief impossible. Heavy local taxation for relief purposes may put difficulties in the way of the expansion of employment in private industry. Again, improvement in the conditions of employment may be secured only at the expense of an increase in the numbers unemployed. Any treatment which overlooked these obvious interactions would be both superficial and erroneous.

## *Relief*

It would probably be admitted by everybody that the support of large numbers of unemployed is not in itself a goal to be pursued. Purely relief measures, then, must be considered as subsidiary to the main lines of recovery. To the extent that more prosperous conditions come about, the need for them will pass.

This is not, of course, to say that expenditures for relief are undesirable or unimportant. On the contrary, they may well be the most impor-

tant thing that can be done during a depression. Where unemployment has been widespread and long continued, the alternative is starvation, demoralization and upheaval. We should not, however, lose sight of the fact that extensive relief measures cannot be, and should not need to be, carried on indefinitely.

Enormous sums, the exact magnitude of which will probably never be determined, have been spent for the relief of the unemployed during the last few years. The funds have been drawn from governmental sources—federal, state and local—from charity organizations of various sorts, and from private individuals, including the families and friends of the unemployed. With the continuation of the depression, the proportion of the expenditures drawn from private sources has become progressively less; governmental bodies, accordingly, have been called upon to assume a larger part of the burden. Many, particularly local governmental bodies, have already reached the limit of their resources, and many others are rapidly approaching that limit. It is evident, if the necessity for relief be admitted, that still more of the burden will have to be borne by the stronger public bodies, notably the federal government. It is equally evident, in view of the financial limitations of even the

federal government, that the ultimate way out can lie only in a diminution of the need for relief.

It may be noted, parenthetically, that there is no reason to believe that a generalized system of unemployment insurance or benefits will do away with the necessity for extensive relief measures. The experience of such countries as England and Germany suggests that during a cyclical depression relief must be widely extended; the insurance scheme itself becomes in large part a purely relief measure on a grand scale, with little more than a trace of true insurance.

The methods of administering relief vary greatly. Payments may be made either in money or in kind. Where payment is made in kind, the motive is usually assurance that the funds will be properly spent. It is doubtful, provided unemployment is genuine, whether such precautions compensate for the administrative complexities introduced. A greater or less amount of work on public projects—or none at all—may be required. It has been argued in favor of such a requirement that it is better to have something produced than nothing. There is strength in this argument; on the other hand, it should not be forgotten that, as a practical matter, relief works are frequently of little value, that the provision of adjuncts to labor is costly

and may result in a curtailment of actual relief, and, finally, that wide possibilities for governmental inefficiency and corruption are introduced. Perhaps the only valid conclusion possible is the negative one that the mode of relief should be varied in accordance with the type and quality of the administering agency, and with the extent to which, in particular situations, the work test is needed to certify the genuineness of unemployment.

At this point it is well to emphasize an obvious truth: Relief costs money. Whether the immediate payment is made by public or by private agencies, the ultimate source of funds must be the money income of individuals. Exception can be taken to this statement only in the event that relief payments are made by an issuance of government paper money, or if bond issues, floated by an expansion of bank credit, produce a result similar to paper money inflation. Even in these cases the result is achieved only by a subtle alteration in the value of money incomes, and the process may not be so simple as its superficial appearance. Barring these procedures, the original proposition holds: Money incomes of individuals form the source of funds for relief. Anything which tends to reduce these money incomes—an increase of unemployment, a decrease of production, a waste of resources—makes

the problem of providing relief just that much more difficult. This fact indicates clearly that we are far from dealing with an isolated problem.

### *Hours*

Before leaving the question of relief, we must consider a totally different sort of measure which has recently attained renewed prominence, the sharing of the available work among a larger number of workers. This expedient is by no means a novelty in this or in former depressions, or even in more normal times. It has been a part of the formal procedure of some trade unions for years, and many others have acted informally along this line. An undetermined but certainly large number of employers have individually run their plants on short time when the volume of business fell off. Last year, the Share-the-Work Movement attempted to bring about more concerted action by the application of moral suasion. This year, the restriction of the working hours has been made an integral part of the codes set up under the National Recovery Act.

It may be objected that the sharing of work more properly belongs under the head of measures designed to increase employment. If two persons are performing the work formerly done by one, it is obvious that there are fewer persons totally without employment. But it is equally

obvious that the total number of employment hours or the amount of productive work has not thereby been increased. In essence, what has happened is merely that the person formerly employed at longer hours has taken over a part of the burden of relief which would otherwise have to be borne by public or private agencies. He has, to be sure, been compensated by an increase in leisure. Whether this is, or is not, desirable may be a matter of opinion, but it is well to understand clearly what is happening.

This aspect of work sharing is even more pronounced when it is considered, not as a temporary, but as a permanent measure of amelioration. For at least a hundred years the idea that unemployment arises out of "not enough work to go around" has enjoyed intermittent popularity. What could be simpler than to cut the number of hours worked by each person to such a point that there *will* be enough to go around? But hours have been shortened and unemployment has not disappeared; nor could any reasonable person have expected that such a result would ensue. Unemployment occurs fundamentally because specific parts of the economic mechanism get out of line. An over-expansion of 10 per cent in a particular industry may have to be remedied by a reduction of the total number of hours worked in that industry; whether the hours worked by the individual

employee are long or short is, from this point of view, immaterial.

The length of the working-day or working-week is of significance for income and leisure rather than for unemployment. Unless working hours are so long as to impair the efficiency of the worker, a general reduction can only be accompanied by a decline in the real income of the community and particularly in the income of the workers as a whole. No one would suggest that half of the population should permanently remain idle, supported by the other half working on the basis of an eight-hour day; yet the effects on real income of a general four-hour day would not be markedly different. Whether the advantages of increased leisure outweigh the reduction of income is a question for workers themselves to decide.

Thus far it has been tacitly assumed that the sharing of work does not affect costs or production. It has been taken for granted, in other words, that the mere work sharing itself does not affect the process of recovery. The validity of this assumption must now be discussed. Does the sharing of work—and here we enter the second division of the preliminary classification—set in motion forces which will accelerate or impede recovery from the depression?

It is probable that no clear-cut answer can be given to this question. Industries differ greatly

in their technique and organization. Even within a particular industry, individual plants show similar variation. What may be possible or profitable for one concern may be quite impossible for another, if it is to survive. Although no general rule can be laid down—and this itself is significant—it is none the less desirable to enumerate a few of the advantages that may be gained or the difficulties that may be encountered in the shortening of the working-day or working-week.

A great deal, of course, depends upon the starting point. If hours have been excessive, a reduction, by minimizing fatigue and improving morale, may lower costs to such an extent that an expansion of production and employment is possible. Reduction of hours from a lower level may have quite the opposite effect; the first and last half hours, notoriously inefficient, bulk more largely in the total working time. The trouble lies in the difficulty of determining the optimum point in any particular case. Certainly a steady diet of twelve hours is not of the best, nor probably is one of ten. For periods of eight hours or less the evidence is not generally conclusive. Whatever the point may be in any particular case, an utter neglect of it will tend to retard rather than accelerate recovery.

The manner in which work is shared must in any case be decided by the necessary technique

of the industry concerned. Whether two or more shifts per day are to be instituted, whether the plant shall be run fewer hours and more days, or more hours on fewer days, whether or not workers shall work longer and fewer shifts—these issues can only be determined by peculiar circumstances. Eventually a point will be reached where none of these methods can stave off an increase in the expense of production. There is evidence for the belief that this point has already been reached during the present depression by a not inconsiderable number of plants and industries.

These retarding influences on recovery may be generalized, but they cannot be avoided merely by group action of the sort visualized in the industrial codes. Each industry is in a very real sense in competition with other industries. In so far as a still broader grouping was effected, the insistence upon costly methods of production could only have the effect of reducing the national income, and the burden would fall more or less equally upon all the participating industries.

Perhaps a more important source of potential increase in costs of production lies in the differing efficiency of individual workers. When men have to be laid off, a certain amount of selection, rough though it may be, is exercised by the employer or his agents. In the absence of rigid seniority arrangements, it is likely to be the worker least

valuable to the employer who is the first to go; he is, then, the one to be taken on again when work is shared. If the original selection has been at all accurate, costs may be expected to increase when new employees are added. As an offset to this, however, must be set the fear of total unemployment. If a concern is definitely committed to a policy of work sharing, the tendency of employed workers to slow up in order to make the job last may be in large part overcome.

The net effect of all these factors is difficult to estimate. Certain it is that it will not be uniform in all cases. In general, it seems likely that the sharing of work tends mildly toward an increase in costs and to that extent may be an impediment to recovery. It cannot, however, for that reason only be condemned. There is much to be said for the improvement in morale brought about by even a part-time job. There is likewise much to be said for a more equal division of the hardships of depression. If other factors are tending to promote recovery, the economic ill effects of temporary work-sharing may be very slight and the social benefits very great. But if we are going to depend upon the profit motive, and if the opportunities for making profits are being consistently suppressed in other ways, the added costs of work sharing might in particular cases be the final straw.

Before leaving this subject, a few words must be said concerning the connection of work sharing with the purchasing-power doctrine. The problems which result when the hourly rate of wages is increased, whether work is shared or not, have been fully dealt with in an earlier essay. The argument has occasionally been advanced, however, that in some curious way the mere sharing of work, without any increase in hourly rates, will increase the volume of purchasing power. It is obvious, however, that the division of an income into two parts in no way increases the size of the original income. Nor is it likely that a significantly larger part of the several incomes will be spent than of the former single income. During a depression, relatively few wage earners have such a large income, even before sharing their work with others, that a substantial portion of it can be hoarded. Savings may be drawn upon and spent, but this may be done by the totally unemployed as well as by those working on part time. In any event, this does not touch the more important types of hoarding or unspent income.

## *Public Works*

We may turn now to a consideration of two types of governmental activity designed to increase, directly or indirectly, the volume of

employment—public works and public employment exchanges.

Public works are not a phenomenon peculiar to periods of depression. Buildings, roads, parks and the like are continually being built and maintained. Ordinarily, for example, public construction has included about one-third of all the construction carried on in this country. But during a depression period, the argument for public works is a double one—the possible fillip to private industry in addition to the more obvious motive of providing employment for jobless workers and idle resources.

It has frequently been suggested that public bodies provide, during periods of prosperity, funds which can be used for public works when employment in private industry falls off. There are difficulties in the way of such a procedure, but in the main it may be said that the suggestion is a sound one. In any case, it is of only academic importance in our present difficulties, for reserves were not set aside for this purpose. In other words, depression projects must be financed out of funds available in the depression.

It is just at this point that the difficulties begin. Local governments in particular, but all governmental bodies generally, have found their revenues tending to shrink steadily. Many of them have been unable to resort to bond issues

because they had already reached the constitutional limit of their indebtedness; others have found that their obligations have not met with a ready reception in the securities market. At the same time, there have been increased demands upon public treasuries, notably for relief purposes. As a result, the expenditures of local and state governments for public works have shown a tendency to decrease rather than to increase during the depression.

As a further result, the federal government has had to provide a larger and larger proportion of the funds. Taxation has been increased and huge issues of bonds have been authorized. Under the terms of the National Industrial Recovery Act alone, the sum of $3,300,000,000 was appropriated for public works. There will doubtless be still further appropriations when Congress is once more in session. It is well to consider whether the expenditure of such huge sums can achieve the purpose for which it is intended.

That a considerable amount of employment can be provided, there is little doubt. Some of this, to be sure, may be at the expense of private employment. To the extent that the funds raised by bond issues consist of funds which would have been used in private industry, there is no net gain; Mr. Harris has indicated that this is likely, at the moment, to be of

slight importance. The effects of increased taxation upon private employment are more complicated and obscure. Perhaps the most adverse result arises out of the unequal burdens imposed upon those regions where prosperity first begins to appear. Recovery may be choked by the heavy taxation which they, on the surface, seem best able to bear. With due allowance for such factors as these, however, it still seems clear that public expenditure can, immediately at least, add to the total of employment.

Whether such employment, apart from its relief aspects, is actually of value is quite a different matter. Experience indicates that work undertaken directly by governmental bodies for this purpose in the United States is never likely to be particularly efficient. "Working for the city" all too frequently connotes sloth, political intrigue and security from overinquisitive supervision. Overhead—particularly of the human variety—is almost sure to be expensive. Frequently also, the projects themselves are likely to be of little value, especially if hurriedly selected and carried out. The letting of contracts involves delay and may invite corruption. All in all, there is no evidence that the community derives as much good from depression public works, considering the amount expended, as it does from private undertakings or even from comparable governmental expenditures in more

normal times. It is not unfair to say that large numbers of public works are really thinly disguised relief works. Relief is necessary, but it is not wise to pretend to ourselves that we are getting a great deal more than this.

Even if the results of public works have a limited economic or social value, the expenditures for them may still be of the utmost importance as a stimulus to the recovery of private industry. In order to have this effect, they must comply with certain requirements that can, in a limited space, only be stated dogmatically. The expenditures must be made at a time when the maladjustments which preceded the depression have been sufficiently wiped out so that an increase in production and employment, once started, may continue. They must be large enough to affect appreciably the extent of consumers' demand. They must be sufficiently concentrated in point of time so that their effects will not be dissipated. None of these requirements is easy to meet, either because of our lack of precise knowledge of the situation or because of administrative difficulties and impediments. On the latter point, events of the last six months offer sad but convincing evidence.

In summary, it may be said that public works provide no panacea for recovery. Properly carried out in timely fashion, they may at once

provide much-needed relief, a measure of results valuable in themselves and a stimulus to an economic mechanism ripe for recovery. At the other extreme, they may be merely a political football and a drain upon harassed treasuries.

It should be noted that the stimulating effects of government expenditures upon private industry may be secured equally well if the expenditures are made for relief rather than for public works. In fact, the greater directness of the relief payments may be expected to give an even sharper impetus to consumers' demand. A smaller proportion is likely to be diverted into channels where it will not be spent quickly. It is perfectly possible, moreover, to set up reserves in more prosperous times against the relief requirements of depression.

## *Employment Exchanges*

Our experience with public employment offices in the United States has been unfortunate. In June of this year, Congress passed the Wagner Bill, designed to bolster up the employment service of both the federal and, by subsidies, the state governments. This is not the place to discuss the ultimate effects of such a measure; the expenditure is relatively small, and the experiment may well be worth while and instructive. A well-run system of employment

offices may not only place men in available jobs but by more rapid and more intelligent placement may actually increase the number of jobs available. But such a system develops slowly, if at all. It is a commonplace that no employment exchange can perform its functions unless employers make use of it. Employers in this country have not, with very few exceptions, gone to the public offices when they needed labor, and nothing has happened during the past year to make them more favorably inclined toward such a practice. In short, there is no reason to believe that public employment offices will play a significant part in the recovery from the present depression.

### *Labor Provisions of the Industrial Codes*

The industrial codes which have been adopted contain various provisions designed to benefit workers already in employment or those who, it was hoped, would soon be employed. Among the most important of these provisions are those relating to hours, minimum wages, child labor, collective bargaining and arbitration. The principles underlying the regulation of hours have already been discussed; the other provisions may now be considered.

The general bearing of wages upon the problem of unemployment has been discussed by Mr.

Chamberlin; only the most summary conclusions need be restated here. The rate of wages may be set at almost any conceivable level, but employers cannot be compelled to hire a given number of men at that level. An increase in the rate of wages means an increase in the costs of production. An increase in costs leads to lower profits and, if profits are nil or negligible, to bankruptcy, or to higher prices. Higher prices lead to lowered output or are a reflection of general inflation. In the first case, employment suffers; in the second, the generally higher prices nullify the increase in wages. The conclusion is inescapable: An increase in the wages of the employed is secured at the expense of greater unemployment.

Two exceptions to this general rule must be noted. If labor is being exploited, an increase in the rate of wages will not result in an increase of unemployment. The presumptive evidence of such exploitation is abnormally high profits. In how many industries or concerns at the moment is this symptom in evidence? Or again, low or negative profits may be the result simply of inefficient management. If higher wages could be counted upon to remedy this inefficiency, the case would be simple. But it is more likely that the inefficient management will fold up completely, particularly after the hardships of years of depression.

In many instances, however, it is probable that wage fixation, either by law or by code, simply cannot be enforced. Already, exceptions have been made for the payment of lower than the minimum wages for handicapped workers and learners; judicious hiring and firing can augment these classes almost indefinitely. Refunds or advance payments by workers as a condition of securing a job have not been unknown in the past. The experience of the states with minimum-wage laws has not been too encouraging to those who sympathize with the purposes of such legislation. In part, the possibilities of enforcement will depend upon the amount of relief available for the unemployed; the lower the level of such relief, the more likely is the employer to stoop to evasion, and the employee to accept it. And relief cannot be continued indefinitely.

In some cases, a rise in the total wages bill has been avoided at the expense of the groups who had previously received more than the minimum. Workers have been discharged and rehired at a lower classification. Salaried workers, in particular, have not benefited from the provisions regarding wages; at the same time they, like others, are paying higher prices for the goods that they consume. Without entering into reasons, it may be stated that differentials will eventually have to be reestablished on

something like the old basis, and that the process of readjustment will not be accomplished without a considerable amount of friction.

Attempts to raise the wages of particular groups, say the unskilled, may react with especial force upon these very groups. Efforts will be made to economize upon the use of such workers by the substitution of other workers or of capital. Workers are in competition with other workers, and the relatively more expensive group will be faced with greater unemployment.

The element of rigidity is almost as important as the question of the actual level of wages. Unless wages are permitted to fluctuate, up or down, as a reflection of changes in the economic situation generally or in particular industries, necessary expansions or contractions will be impeded. In most cases, a very slight change in the rate of wages will be found to have a considerable effect upon the volume of employment. In this connection, the remarkable correlation between real wages and unemployment in Great Britain during the last decade is highly instructive.

Provisions designed to remove the evils of child labor deserve the widest sympathy. It must be kept in mind, however, that such provisions do not automatically enforce themselves. The temptation to evasion is greater

than usual when concerns are working on slim margins and family incomes are low. Only time can tell whether the codes will have succeeded in abolishing the worst of the abuses. Honest and efficient inspection will be necessary, and it must be of a sort more effective than that which exists today in most of our states. We can only hope that this will be secured.

Almost all students of labor problems are in agreement that wisely led organizations for collective bargaining can do much, not only for the economic and social betterment of labor, but also for the improvement of the general welfare of the community. Only a small proportion of workers in this country, however, have been organized. In an attempt to promote organization, the National Recovery Act provides that all approved codes must contain, among other things, the following conditions: "(1) That employees shall have the right to organize and bargain collectively through representatives of their own choosing, and shall be free from the interference, restraint or coercion of employers of labor, or their agents, in the designation of such representatives or in self-organization or in other concerted activities for the purpose of collective bargaining or other mutual aid or protection; (2) that no employee and no one seeking employment shall be required

as a condition of employment to join any company union or to refrain from joining, organizing, or assisting a labor organization of his own choosing."

On the surface, these conditions seem to assure a golden age for labor organization. But it would be dangerous to predict that such will be the case. The results to date, even taking membership figures of trade unions at their face value, have been surprisingly meager, and reasons are not hard to find. Legislation may succeed in removing barriers to the organization of labor, but it can hardly hope to force such organization in the absence of favorable conditions. The prohibition of "coercion" is likely to be meaningless. A worker may not be discharged because of union affiliation, but discharges for inefficiency may be largely confined to active members of unions. If membership in a company union seems to offer more, shall that be called coercion? The suggestion that a firm may move to a locality where unionism is less prevalent or may close down entirely may not be coercion, but it may be none the less effective.

Workers will not flock into organizations unless they feel confident that they stand to gain thereby. It must be confessed that the general run of leadership in American trade

unions during the last decade has not inspired such confidence. Some of the leaders of labor have been little more than racketeers, others have been interested only in maintaining their own political machines and many more have been simply moribund. Although prosperity favors the growth of organization, American union membership showed a tendency to decline during the boom period. At the present time, many unions are torn by internal dissensions and are unable to take advantage of their opportunities. Workers who are willing and eager to organize are unwilling to throw in their lot with the old-line unions. The prevailing form of organization, by craft or trade, is an unwieldy vehicle for negotiation along industrial lines.

In these circumstances, it remains to be seen how much advantage the unions can glean from the official encouragement which has been given to them. The real test will come when recovery is well under way. American industrialists are not likely to acquiesce passively in a wide extension of unionism. It may be recalled that the period of government sponsorship of organization during the World War was followed by concerted open-shop activity and by a decline in union strength.

Formal arbitration has had only a limited success in this country, and that only in a few industries where the mechanism has been built up by the interested parties themselves. The most ambitious governmental project of recent times, the Railway Labor Board, was abandoned after a brief experience. No matter how capable or conscientious the arbitrating body, it is difficult to keep the impression from arising that it is biassed in favor of one or the other party. The structure of formal arbitration, moreover, is likely to be cumbersome and to contribute to the rigidity of wages. It is well to have available a body to which disputes may be referred by the parties concerned, but it remains to be seen how far traditional methods will be abandoned and whether capital and labor can be induced wholeheartedly to resort to arbitration and mediation.

To the extent that the preceding discussion has been adversely critical of official policies of the last year, the quarrel is rather with the methods pursued than with the aims envisaged. In my own mind, there can only be an affirmative answer to the question, Should conditions of labor be improved? It seems clear, however, that certain policies, such as those with respect to wages, can have only an unfavorable reaction

upon those whom they are primarily designed to benefit. With regard to certain other policies, such as the encouragement of organization, I suspect that official interference can only scratch the surface. At the moment, moreover, recovery is of the utmost importance. The accomplishment of programs desirable in themselves may be indefinitely postponed if recovery is impeded.

# HIGHER PRICES

*By* S. E. Harris

## *The Money Lever*

In recent years, there has been a growing demand for monetary measures as the means of improving the economic situation. The explanation is simple: Non-interference leaves private enterprise with the responsibility of getting its house in order, and the process is painful. It is rather paradoxical that we should apply the monetary term deflation to a process which is non-monetary; for cutting costs, reducing wages, writing down capital charges and other debts, reducing supplies in overexpanded industries, weeding out the inefficient, are all non-monetary events, but, like most monetary measures, they influence the volume of bank credit outstanding and the price level; and the public takes what is a result, namely, the reduction of credit and prices, as the cause and even the process itself. It is a mistake, therefore,

to think of deflation as a monetary policy or group of monetary measures, unless the banks take the initiative in reducing the volume of credit, which is not generally the case; and it is a mistake to assume that deliberate inflation is the opposite of this kind of deflation. The process generally referred to as deflation is usually not brought on by monetary measures; but monetary acts and policies play a decisive part in inducing inflation.

Non-interference is distasteful to those who are confronted with the necessity of taking losses and accepting lower wages; and it becomes increasingly distasteful as the resistance of workers and holders of capital equities prevents the introduction of necessary adjustments in wages and capital costs and therefore *unnecessarily* increases the extent of the unemployment of the factors of production. The clamor for help from the Government becomes more persistent and finally the Government yields. Monetary measures are popular because they promise immediate relief, can be applied with a minimum of effort on the part of the authorities and do not require a careful study of the condition of individual industries and business units. This holds at least for open market operations, the monetary remedy nearest at hand; direct

advances of funds to industry make larger calls upon the bureaucratic machinery and are not so easily applied.

The Hoover Administration tried to grapple with the depression by mistakenly urging business men to keep up wages and (hence) prices, and, finally, by resorting to monetary measures. The Roosevelt Administration has relied for the most part on non-monetary measures; at least, this was true until October, when the setback to business and the pressure of inflationists led to the introduction of the new gold policy. Monetary laws there are in the Recovery legislation; but it can hardly be said that either these laws or administrative acts under them were among the most important causes of the midsummer improvement and the subsequent decline in business activity. Nobody would deny that the threats of inflation they contain and the failures of the Administration to deny rumors of the imminence of inflation have been important factors in bringing higher prices; and the new gold policy introduced in October, 1933, apparently has contributed to an undermining of confidence. It seems preferable, however, to distinguish these psychological effects from the other effects of these measures on the economic organism. And even as to psychological factors, it may be said that the processing

taxes and the N.R.A. policy of higher costs were more effective, last summer, in inducing the expectation of higher prices which started them upward than were the purely monetary measures. The Administration, however, has paid more attention to monetary palliatives since the collapse of the midsummer boom, exhibiting somewhat more awareness of the need for enlisting the cooperation of the banks than it displayed in the first six months after March 4 last. During that time, it neglected real monetary measures and frightened the banks; a policy which to some extent has already proved costly.

Higher prices, which have been the most important, immediate objective of the Roosevelt Administration, may be brought about (1) by restrictions of production, (2) by transfers of purchasing power from non-spenders to spenders, and (3) by the creation of additional purchasing power through the banking system or government printing presses. The Administration has relied almost exclusively upon the first two methods of raising prices, and the third has remained little more than a threat at least until October, 1933. Transfers of purchasing power from non-spenders to spenders may influence prices as effectively as the creation of additional purchasing power and therefore

might be considered a monetary measure; but because the term "monetary measures" has generally been reserved for changes in the supply of money, whereas the emphasis, when transfers are under consideration, is placed upon the demand for money and therefore upon the processes of production, employment, expenditures and the like, I prefer to call the compulsory transfers to spenders non-monetary measures; though like most non-monetary policies, they have important effects on the price level.

### *Spenders and Non-spenders*

Most of the important legislation of the present administration will result, to some extent, in transfers of purchasing power from non-spenders to spenders. During depression, the well-to-do classes probably cut both their consumption expenditures and their investments more than their incomes are reduced; they become, in a measure, hoarders or non-spenders. Thus all legislative measures which succeed in increasing, at the cost of these classes, the money income of the farmers (as a body) and of labor (employed and unemployed) may be expected to increase spending and raise prices. The farm and wage legislation, unemployment relief and public works programs of the

Administration are discussed, from this and other points of view, in other essays in this pamphlet. But a few limitations on the possibility of increasing spending (which includes investment) by such transfers of money from the "upper" classes to the farmers and to labor must be mentioned here. The farmers may use additional cash received, to make payments on mortgages and build up sadly depleted bank accounts; and the banks and mortgagees may not convert these savings into investments. So far as this happens, no increase of spending occurs. Again, all the measures referred to may, in part, diminish not the hoards but the investments of the well-to-do, thus merely changing the form and incidence of spending, not increasing its amount. Finally, as depression and the new attitude toward capital take their toll in the reduced standard of living of the "upper" classes, it becomes increasingly necessary for them to cut hoards rather than (consumption) expenditures, as their standard approaches what they consider a minimum; and they cease to be a class of non-spenders having idle money which can be made more active by transferring it to other classes.

Additional doubts arise on this vital issue despite the fact that many of the policies recently introduced stimulate expenditures on

the part of either private spenders or the Government. The difficulty is that these transfers to favored groups frequently represent additional costs to producers. Entrepreneurs may profit from the increased expenditures both because they may be able to sell a larger volume of goods and because they may gain from rising prices (not offset by a corresponding reduction in sales), for capital costs are fixed in dollars and receipts in dollars rise. On the other hand, they will lose from higher labor and raw material costs and higher taxes and perhaps from higher costs for new borrowing. The higher costs for raw materials reflect the new agricultural policy, and the higher costs for wages reflect the N.R.A. policy of higher wages per unit of output. The large public works program, however, increases expenditures with a minimum increase in costs. The point is that increases in costs of production nullify the effects of increased spending by the public as a stimulus to business activity.

### *Why Higher Prices?*

When costs are too high for profitable business enterprise, the relief offered through rising prices may be an important incentive to increased production; but we must not lose sight of the fact that higher prices are but a means

to an end. If capital costs have already been reduced by defaults, bankruptcies and the like, they are already at a minimum; and if the temper of the administration and of labor precludes any reduction in real wages (that is, makes it necessary to raise money wages along with prices), higher prices may be ineffective. For costs may not be reduced much and, therefore, an increased volume of production may not be attained; and the higher prices, by absorbing available purchasing power, will prevent the latter from increasing the demand for the factors of production, while the threat of unorthodox policies may contribute to the shattering of confidence.

A larger volume of output at a higher price level will give the entrepreneur the maximum relief. I leave out of account here the disturbance to confidence resulting from the high price policy, for the assumption of a higher level of production can be made only on the theory that the impairment of confidence is not serious. The gain is then at a maximum because the entrepreneur pays out (the assumption is that no additional outlay on plant is necessary) in bonded interest and the like an unchanging number of dollars, while he obtains more dollars both because prices have risen and because the volume of production has increased. In addition,

he may benefit from any failure of wages to rise as much or as rapidly as prices. The conclusion is, therefore, that higher prices are a means toward an end, and that the end will be achieved only if the method of raising prices does not destroy confidence and does not involve an equal increase in money costs of production.

For still other reasons, we cannot be at all sure that the objective of higher prices and an increased volume of production will be attained through stimulating additional expenditures. Whether it will or will not also depends upon the attitude of the banks and of the entrepreneurs toward higher costs or upon their estimates of the possibility of getting more than bare compensation for the higher costs. Should the banks and the entrepreneurs be skeptical, then the new policies may lead only to a diminution of the total volume of credit, which in turn would result in either a decline in prices or the financing of a smaller volume of trade at the higher price level. The improved business conditions of the summer of 1933 were possible in spite of doubts concerning the new policies, because rising costs and therefore the anticipation of higher prices stimulated consumers and middlemen to buy in anticipation of a rising price level, thus inducing higher prices although the *volume of trade* financed by banks was

reduced, and entrepreneurs relied on accumulated balances.

### *The Government Can Raise Prices*

I turn now from non-monetary to monetary measures for raising prices, that is, to inflation. There can be no doubts concerning the capacity of the Government to raise prices by inflation if it really is determined to do so. One need only recall what was accomplished during the War. Today the Government need only extend its policy of large public expenditures sufficiently, in furtherance either of public or of private enterprises, in order to assure the nation of higher prices. It is true that as the announcement of its new gold and other monetary policies impairs confidence further, the volume of government spending in order to achieve a designated price level will have to be increased, as the shattered confidence leads to less spending and less investment from private sources. But as long as the Government is prepared to spend even to the extent of undertaking complete control of price industry through financial subsidies (which probably will not be necessary, for additional public spending will stimulate private spending as business improves), the objective of higher prices will be achieved. For that reason, such policies as the N. R. A. and

the new gold policy may well be viewed with distrust by those who are hostile to government control of industry, for the resulting loss of confidence makes necessary a larger volume of public spending, or private spending of public funds, in order to achieve the desired price level, than would otherwise be necessary. But if the Government finances public works and private enterprises on a large enough scale, the prices of commodities and services are bound to rise, as increasing supplies of purchasing power are created or diverted toward the markets. Only as far as the process itself leads to increased production or offer of commodities and services to offset increased supplies of money will the plans of the inflationists be frustrated or at least interfered with; but nobody will question the relatively greater elasticity in supplies of ink and bookkeepers than in those of goods and services in general.

### *The Hoover Experiment*

To understand the skepticism that still is prevalent in regard to the capacity of the Government to raise prices one must recall the failures of the Hoover administration, which prove only that its faith in the efficacy of open market operations was not justified. Had that Administration attacked the problem by pro-

viding adequate demands for the funds made available, that is, an adequate volume of expenditures, it might not have failed.

It is important to review the failures of the Republican Administration, both to support the position taken above, and to warn against exaggerated hopes for the use of open market operations to raise prices. This method, tried on a very large scale in 1929–1930, and on an unprecedented scale in 1932, failed both because the downward movement of prices was not checked and because the number of bank failures continued to increase. Of course, the achievement of either of these objectives would probably have assured the other; prices continued to fall, in large part because banks failed (and therefore purchasing power was destroyed), or for reasons similar to those that were contributing to bank failures; hence a diminution of the number of bank failures would have been both a symptom of improved conditions and a factor contributing toward higher prices; and if the downward movement of prices had ceased, the failures of banks would have become much less numerous.

The traditional view is that reserve banks, by purchasing securities on the open market, provide the money market with additional cash which is used to reduce indebtedness at

the reserve banks, and a reduction of these debts makes the banks more willing to lend. It is at once evident that the same volume of open market operations would be a greater contribution toward higher prices if the banks receiving the additional cash should hold on to it, thus increasing their available reserves, than if they use it to repay debts. That they did not hold on to it in 1932 was so much more evidence that the necessary confidence was not present; they were not afraid to be in debt in 1928–1929. The volume of operations had to be larger, also, because the additional cash intended to raise prices was so largely consumed in satisfying the need for more currency at home, and in payments for gold to meet the adverse balance of foreign payments following the announcement of what was considered an unorthodox and inflationary monetary policy. Capital left the country because the depressing business situation threatened capital equities; and when a policy of inflation was foreshadowed as a means of making real costs lower and business profits possible, foreign and even domestic holders of rights to a fixed number of dollars began to withdraw their dollars. The palliative, therefore, was not successfully administered, both because the ultimate effects upon the cash reserves of banks were disappointingly small,

and because the banks were not even disposed to use these additional resources while prices continued to fall. Had these operations been accompanied by provisions for large public expenditures, the tendency of prices to decline might have been checked.

The other cause of failure was continuance of bank failures. Banks fail because they lose deposits too rapidly. Their obligations are fixed in dollars but the value of their assets declines with the decline in prices. As depositors withdraw their deposits, either because they need cash or because they are frightened, banks are forced to dispose of more non-cash assets, thus accentuating the downward course of the dollar value of assets. Such pressure on the banks is peculiarly strong in certain sections of the country, because of local economic conditions. The West and South have long suffered from a disadvantageous disparity in prices between the commodities they sell and those they have to buy, the low prices obtained for their products not being compensated by a correspondingly larger volume of sales. In view of the fact that their demand for the commodities and services of other sections of the country and for those of other countries has been inelastic, the only corrective available has been to pump additional cash into these sections

of the country to offset the large losses of deposits symptomatic of the unfavorable balances. Since these sections in their external trade have been sending out more money than they were taking in, the result has been a fairly steady loss of bank deposits in these regions. (Compare the proportion of total deposits of the banks in agricultural sections in 1933 with the proportions in the years 1920 and 1930.) Loans of all kinds, purchases of assets by the reserve banks and the R. F. C. as agencies for collecting cash from the financially strong East and pouring it into the West and South, and finally the steady series of debt defaults have been the methods of adjusting these balances. For the West and South have not been able to adjust them, otherwise, by sufficiently reducing their "imports" (necessarily financed in part by borrowing in the East), and increasing their "exports" through price concessions, on account of the inelasticities of demand on both sides of the interregional trade.

Open market operations are not the most effective method of dealing with the problem of bank failures, any more than the proper way of filling numerous small holes on the surface of the earth is to flood the earth with water; for even if open market operations succeeded in stopping the decline of prices, numerous

bank failures might still plague us. Open market operations provide the banks of the country with cash and make unnecessary additional sales of assets. Unfortunately, however, the cash does not necessarily go to the banks that need it most, although they all gain more or less from the inward movements of cash and deposits as well as from the resulting upward tendency of prices. The cash tends to go to the stronger banks, that is, those that tend to gain deposits while the others continue to lose. Direct advances either by the R.F.C. or the reserve banks are the only sensible method of coping with this problem. But even this method is not always effective; thus in 1932 and the early months of 1933, the reserve banks pumped out more than one billion of additional cash, and the R.F.C. obtained more than two billions of dollars, for the use of banks and railroads. The burden of making large transfers to the West and South was put upon the East, by appealing to Eastern investors and reserve banks to finance the agricultural sections. Where did the cash go? It went to the stronger banks in the West and South, which quickly redeposited it in the large banks in the financial centers, particularly in New York, the latter being lulled into a false sense of security. The spread of banking infections to strong

banks in the agricultural sections, which now had to withdraw cash deposited in the East, necessarily made the position of the strong banks in the East vulnerable, for they had already suffered from the sale of government securities.

### *Inflation in* 1933?

We have seen that the attempts to stop the decline of prices on the part of the Hoover Administration were unsuccessful; what of the policies of the Democratic Administration which have so far (I write in November, 1933) brought us rising prices and a boom of several months' duration although the volume of bank credit is considerably less than it was early in 1933? An anticipation of curtailments of production and of higher prices accounts for the increased activity of deposits of consumers and entrepreneurs which made possible the restocking and higher prices of the summer of 1933. The large increase of deposits, since April, of banks operating on April 1 (in contrast to the relative stability in dollars of earning assets of member banks or their reduction in dollars of stable purchasing power) is more than accounted for by the exchange of hoards of cash into deposits with the return of confidence in the banks. That, despite an increase in prices of 20 per

cent, deposits are still approximately 10 per cent below the total held before the epidemic of bank holidays is deserving of comment.

The failure of the Administration to achieve rising prices for a longer period *and* an increase in supplies of money and deposits proportionate or more than proportionate to the rise in prices may be explained by the delay in spending Government money. The measures introduced for the purpose of assuring the use of increased supplies of money made available require time for their application; but ordinary Government expenditures were cut early, and the program to increase costs through means other than public expenditures, in particular the Recovery and Farm legislation, was put into effect almost immediately. In the absence of additional spending activities on the part of the Government, the various monetary acts have not played an important part in the economic rehabilitation of the country. True enough, with the reopening of banks after the Bank Holiday, there was a return of confidence in our banks. Thus some activity in our bank deposits was ultimately infused; but, on the other hand, closing of banks with many billions of deposits contributed toward further price declines which to that extent further impaired the position of the relatively sound banks.

Monetary legislation, not supplemented by measures providing for the expenditure of the additional money made available, will not produce inflation. Furthermore, the resulting shocks to confidence of these purely monetary measures make imperative non-monetary measures for accelerating the rate of expenditures, for the loss of confidence is felt at first in a rush for cash and the sales of non-cash assets. This propensity to hoard will do business much harm. The initial loss of confidence, which is expressed in an increased demand for cash, is to be differentiated from the loss of confidence in money that comes at a later stage when expenditures of the additional money provided have succeeded in sending prices skyward and therefore in driving the public from cash to non-cash assets.

The power given to the President in the Thomas Amendments to the Farm Bill—that of increasing the total amount of money through various means—has not been used to any significant degree as yet; the stage is set, however, for an explosion if conditions conducive to expansion appear. The amendments give the President discretionary authority to increase the total amount of money through the issue of greenbacks, through devaluation, or through sales to reserve banks of Government securities,

or purchase of securities in the open market by the reserve banks (the latter two by agreement with the reserve authorities). The purchases of securities by the reserve banks since April, which have provided the banks with 500 millions additional of cash, may, however, be in response to official pressure, and preparations are being made to devaluate. The abrogation of the gold clause has operated perhaps to reduce the demand for money needed to pay debts and thus has contributed toward higher prices; on the other hand, along with other legislation directed toward destroying capital equities or discouraging investment, it has had a depressing effect upon business psychology and thus has contributed to the inactivity of bank deposits. It is very doubtful whether the Securities Act has played a large part in bringing about the recession of business in the last months of 1933—issues were at a minimum before its passage. With more favorable conditions, however, the Securities Act may become a greater obstacle to recovery.

### *Driving Out the Borrower*

The fact that the measures taken by the Government have tended to raise doubts in the minds of the investor has made all the more necessary additional Government expenditures.

Both because the business situation has not been too promising, and because the policies of the present administration have not been friendly toward capital, the trend has been toward short-term investments, particularly in the short-term paper of the Government. By contributing to the elimination of profits and even of business income necessary to meet fixed charges, the Government has been instrumental in driving lenders toward the markets for Government paper and securities. The procedure is simple: Private business is made unprofitable and therefore investors desert private security markets, while at the same time the appeals for Government intervention become more frequent; the increased demands for Government funds are not yet destructive of Government credit because the policies that have partly contributed toward unprofitable business enterprise have also made investible funds move in the direction of Government security markets. It is not therefore so paradoxical as it seems at first that the Government is able to borrow for short periods of time at a rate frequently as low as one one-hundredth of 1 per cent and that the larger the supply of Government securities offered on the market the lower the rate seems to go—prices increase with increasing supplies of securities offered. That the investors favor

Government over other securities is not surprising, even if as a class they are suspicious of the Government; for though they may have doubts concerning the dollars in which they are paid, they know that the Government alone can make sure of payments in dollars of some value or other, and that the policies of the Government may make impossible payments by private business enterprise. On the other hand, the investor, dubious of the future, does not want to make commitments for appreciable periods of time, even by buying Government securities. It is no surprise therefore that the proportion to the total Federal debt of 18 billions in January, 1932, of floating indebtedness was but 20 per cent (3½ billions) as compared with almost one-third (8 billions) of the debt of 23 billions in October, 1933.

### *One One-hundredth of One Per Cent*

How long can this process of borrowing at ridiculously low rates on the part of the Government continue and how long will it be before the bond market suffers? It may be pointed out here that a rise in bond rates resulting from additional issues is not a calamity, for new issues are desired; and though rates rise with increased issues, the additional employment and production may well justify the increase in

rates. Will the commitments of the Government which may, within the next fiscal year, require the sale of 5 billions of securities to cover deficits, send rates up? Member banks hold approximately 800 millions of surplus reserves (the surplus is much larger if allowance is made for pyramiding through balances held with members by non-members) which they would gladly put into Government securities if a respectable rate, even as low as 2 per cent, were offered on short-term securities; therefore any rise of short-term rates, not of a panicky nature, would lead to large and important reactions on the supply side which would put an end to the upward movement of rates. The danger of marked increases in the rate at which the Treasury borrows, both short and long term, arises, however, from the possibility of using up these surplus resources of the banks (which, of course, may be increased through operations of the reserve banks) or from the threat or actuality of inflation resulting from expenditures following the use of the funds thus obtained from the banks. Rates would then rise both because inflation threatens (rising prices make lenders less eager), and because the rising prices may be accompanied by improved business conditions and therefore by renewed demands for funds by private borrowers.

Recent discussion of the danger to Government credit of inflation, seems to me to be beside the point. Inflation is an opportunity to improve the government's credit in the sense that it is a means of reducing the cost of borrowing both past and present. That the price of Government bonds has declined a few points is, therefore, in spite of the large demands to be made on Federal bodies, no tragedy; it simply is a sign that the public is beginning to take the threat of inflation seriously. History teaches us, however, that the public does not take the threat so seriously as they ought to do and therefore allows the Government to continue to exploit them, for the increased return paid on even those Government securities issued in the inflation period is not commensurate with the losses suffered by bondholders through inflation; and as far as the large issues of the past are concerned, the public has no alternative but to accept its losses. If the Government could not force the banks to take securities directly, or force them indirectly by flooding them with cash or making private enterprise unprofitable, then it is at least *conceivable* that Government credit might begin to suffer, in the sense that the *real* cost of Government borrowing, past and present, might begin to rise; but this is not a practical possibility.

## *Tests of Government Expenditures*

Private borrowers have become ineligible borrowers both because the economic situation has become worse since 1929, and because governmental interference has further reduced the possibilities of profitable business enterprise. The Government has thus become the most important eligible borrower. Washington can always force the banks, directly or indirectly, to purchase Government securities; moreover, adequate sales to the reserve banks or issues of greenbacks to meet Government expenditures would provide banks with additional cash, which could find an outlet, under present-day conditions, only in government securities. For these reasons, and because there are limitations on the amount of public borrowing from banks that can be effected without raising our prices excessively, the Government ought to make certain that the funds raised through its sales of securities or notes are used in the manner most conducive to economic improvement. The whole process is one in which the responsibility of the Government becomes one of spending more and inducing more employment as the business situation becomes worse. It is a race between the diminution of private expenditure and the increase of *effective* public expenditure. The

former may well begin to increase, however, if public expenditures once attain the objective of raising prices and increasing production. Public expenditures which merely stimulate the growth of inactive deposit accounts or which provide the public with cash which is soon used to repay bank loans, or which provide the means *merely* of raising the prices of available supplies of commodities and capital goods, are of less immediate importance than those which stimulate directly the utilization of unemployed factors of production.

This observation holds, for example, for payments from the Treasury of the funds necessary to carry through the guarantee of bank deposits. They will contribute to additional employment only in so far as the improved position of financial institutions *ultimately* leads to an increased disposition on their part to invest more freely. The guarantee will have deflationary effects because it arouses in bankers distrust of the economic programs of the Administration, and because the banks pay too much attention to liquidity until they are found to be in a condition liquid enough to warrant their acceptance as insurable banks. On the other hand, the increased confidence in the banks resulting from these measures may reduce withdrawals of deposits and therefore encourage a

freer lending policy on the part of the banks. Loans to banks and railroads through the R.F.C. also contribute to a sounder position of banks and therefore to a more liberal lending policy and more confidence in the banks. These public expenditures, which in addition merely make possible the meeting of fixed charges (to a lesser degree, labor charges) cannot otherwise be justified on the basis of what they will do to employment. Expenditures on public works are to be heartily approved unless they stimulate production of capital goods relative to consumption goods for which a new demand is now induced to such an extent as to cause unhealthy increases in the price of consumption goods.

### *Going Off the Gold Standard*

The abandonment of the gold standard has been justified on the grounds that freedom was necessary in monetary affairs if the country was to be successful in raising prices in the face of anti-inflationist sentiment in other countries. Unfortunately the opportunity has been used to introduce the N.R.A. and other measures which, whatever their long-run effects, certainly have not contributed toward an increased volume of production. It has sometimes been forgotten that the attainment of a higher price level was only

a means toward the end of increasing employment and production.

The temporary closing of the banks of the country early in March, 1933, was in itself an abandonment of the gold standard, for not only could one not obtain his dollars from the banks but the banks were not allowed to pay out gold for dollars. Because the closing of the banks had been preceded by large losses of gold, both to foreigners and to Americans, the Government took advantage of the newly assumed control over the payment of dollars by the banks to take over control of the outflow of gold both to Americans and to foreigners. Strangely enough, the control of gold movements was not accompanied by any marked weakness in the dollar. The explanation is undoubtedly that the return of confidence following the opening of approved banks resulted in some return of the capital and gold exported in earlier months. In truth, the exports of gold in April were negligible, although the threats of inflation embodied in the Thomas Amendments to the Farm Act stimulated outward movements of capital late in the month and probably would have resulted in losses of several hundred millions of gold in the absence of the embargo introduced late in April. Had the Government been prepared to allow a moderate amount of gold to flow out,

which easily could have been spared, the announcement of a virtual prohibition of the exports of gold would not have been necessary. Losses of gold would have ceased as the public began to realize that the Thomas Amendments were, at least for the time being, rather innocuous.

Actually, this extreme measure of imposing an embargo on gold exports was taken in order to make certain that all speculative movements against the dollar were fully effective and that the pressure was not eased by satisfying the demands for foreign currencies with releases of gold. Furthermore, the very announcement of this policy was bound to encourage the speculative movements that had at an earlier time made some impression upon our gold supplies and, therefore, was likely to depress the dollar further. The Government was determined to depress the foreign value of the dollar abroad and the widely held opinion of imminent inflation was exploited by the Government for the purpose of driving capital out of the country and thereby reducing the value of the dollar. Threats of inflation were not denied and the introduction of the N.R.A., which constituted a threat to capital equities, provided an additional reason for deserting the dollar. That the

Government continued its attempts to depress the dollar is evident in the movements of gold from April to October. Gold previously earmarked and some newly mined gold was allowed to go out; but, despite the depreciation of the dollar and the increase in gold reserves, the virtual ban on gold exports continued.

As I write in November, 1933, the abandonment of the gold standard seems to have been a doubtful measure; in March or April, the need for an independent monetary policy which would allow the Government and the banks to finance new enterprise generously—and to an extent that might not have been possible in the framework of the gold standard—seemed imperative. The abandonment would have been justifiable (though we now see that it was not necessary) if other Government policies had not defeated the purposes from which it might have derived its justification. Thus the measure is doubtful, not only because it now seems probable that a large program of public expenditures is practicable within the framework of the gold standard, but also, and more important, because the introduction of the embargo, with resulting shattered confidence, necessitated larger public expenditures than would otherwise have been needed. Most important, the embargo

gave the Government the courage to experiment with fatal high cost policies, of which the N.R.A. in some of its aspects is typical.

### *International Repercussions*

Wholesale prices in the United States rose 18 per cent in the months April to September, 1933, as compared with increases of 6 and 2 per cent in Great Britain and France. The respective movements from January to September were rises of 18 and 3 and a decline of 4 per cent. It may be noted that the depreciation of the dollar was approximately 25 per cent in sterling and 33 per cent in the franc, a depreciation very considerably greater than that indicated by the relative movements of prices.[1] Though the value of gold fell, gold prices of American commodities declined.[2] Close agreement in the internal and external depreciation is not to be expected. In fact, the impairment of the competitive position of the United States (resulting from the various high cost policies and the discouragement of the export trade) ought to be accompanied by a reduction in the gold price level in the United States, or at least in American prices relatively to others. Therefore the reduction in gold prices here, resulting

[1] Exchange movements from January to October.

[2] That is, the world value of gold declined from April to October.

from the relatively moderate increase in prices in contrast to the large depreciation of the dollar, may be considered a corrective. It is, however, not likely that the gold prices in the United States would have responded so quickly in the absence of artificial measures to depress the dollar abroad.

Having found an external depreciation helpful, did Great Britain take defensive measures to stop the appreciation of sterling in dollars after April? Interference on the part of British authorities may perhaps be presumed, at least for the period until well into October, judging from the relatively larger decline in the value of the dollar in francs than in sterling; but more recently the drop in the sterling quotation of the dollar has been especially precipitate. Great Britain has been more successful than has been France in preventing an appreciation of its currency; but the former's success was not startling, and late in October and in November sterling rose much more rapidly than did the franc. Doubts concerning France's fiscal condition now played a part. Not restricted by the demands of a gold standard, Great Britain has been able to pursue a fairly liberal internal monetary policy during this period, as is noted below. Although her imports of gold from April to September amounted to approximately

300 million dollars, her holdings of gold reserves remained almost unchanged during this period, an indication that the large supplies of gold imported in these months had been included in her reserves even when held abroad.

Large speculative purchases of sterling have occurred in recent months. There is evidence that the British authorities have intervened by dumping sterling on the market to offset the increased demand, thus attempting to check the upward course of sterling. In October and November, they either have hoarded the foreign currencies thus obtained or (to a limited extent) have converted them into gold. The rapid decline of sterling, especially since October, is evidence, however, that the efforts of the authorities have not been very successful. This decline, in addition to the domestic policy, is also evidence of a realization that the costs of inflation, i.e. keeping pace with the expansion in the United States, would be higher than the gains to be obtained from keeping the dollar from appreciating further.

The English authorities have apparently not been anxious to introduce a measure of internal inflation adequate to stop the appreciation of sterling in dollars; while capital was moving at a rapid rate into England from the United States, a rise of prices of larger proportions than that occurring in the United States would have been

necessary, at least until the inflationary threat in England began to influence the direction of speculative movements. Furthermore the English, not being ready for a large dose of inflation, would have taken a risk in accumulating too many dollars and other currencies, even francs, for the pounds obtained through the Equalization Fund, and, therefore, the Government would have suffered large losses with the further depreciation of the dollar.

Whatever gold arrived in England from December, 1932, to October, 1933, has been used largely to strengthen the reserves available against currency notes. The reduction in the volume of earning assets by the Bank of England, the transfers from Bankers' Deposits to Government and Other Deposits account largely for the additional supplies of gold and, since the reserves of member banks increased little, only a moderate basis for expansion remained. Both in 1932 and 1933, the banks in England have been allowed to increase their reserves to a moderate extent, the additional cash being used at first to increase holdings of securities and bills and more recently to pile up excess reserves.

## *Varying the Buying Price of Gold*

The announcement by the President, on October 22, 1933, of a plan to control the gold market indicates a determination to keep up

and even raise the price of gold in dollars. The procedure for raising the price of any commodity is either to reduce the supplies appearing on the market or (and) to increase the demand for it. By locking up (or hoarding) gold purchased by the R.F.C. from the miners or other sellers, the Government can reduce available supplies; by creating additional money (or borrowing from the public) the Government can increase the demand for gold. The R.F.C. need only bid a price above that offered by foreign purchasers in order to become the purchaser of supplies appearing on the market.

Why should the Administration be interested in raising the price of gold, and what significance are we to attach to its efforts if successful? It is apparently proceeding on the principle that a higher price for gold will be followed, or attended, by higher prices all around. But this does not by any means follow; and the increase in the price of gold may be of limited significance. If the market for gold and the issue of currency notes and of credit were free in the sense that the restrictions to be associated with the need for convertibility into gold were not a deterrent, then the increase in the price of gold would be a fairly accurate barometer of a general rise of commodity prices. But a high price induced by official control is another matter; the rise in the

price of gold is explained by restrictions of supplies flowing on the market and artificial diversion of dollars into that market. Other commodity prices might even go down just because purchasing power has been diverted to that other commodity market—gold.

The intention is evident: The value of gold is to be raised artificially both in terms of commodities as well as in gold. Therefore, both the commodity and the dollar value of gold would rise at first; but as (later) the dollar price of commodities rose, the commodity value of gold would tend to fall back to its old level so that ultimately an ounce of gold would buy more dollars than today but no more commodities. The time would come when the dollar would buy no more in commodities than it did in 1924–1926; a dollar would be valued in the market at only (say) one-fortieth of an ounce of gold instead of the normal one twenty-first of an ounce of gold. Therefore in order that the dollar should once more purchase in goods the equivalent of its purchasing power in 1924–1926 and at the same time have once more a fixed value in terms of gold, it would be necessary for the dollar to be redefined (devalued) in terms of gold; the price of an ounce of gold would be set at $40 (say), and this $40 (an ounce of gold) would buy approximately what $21 (an ounce of

gold) bought in March, 1933, and perhaps $29 (an ounce of gold) in October, 1933.

The aim of the Administration is to maintain the value of an ounce of gold at somewhere near its present value in terms of commodities, but to raise its value in terms of dollars and reduce the commodity value of the dollar to the 1924–1926 level. Thus it is necessary not only to make gold scarce relatively to commodities (at first), but also make commodities scarce relatively to dollars. The problem of getting more dollars or more active dollars still remains, and the redefining of the dollar helps in so far as more gold dollars become available for expansion (as bank reserves) and hurts in so far as confidence is impaired by tinkering with the monetary machine. Any success in raising prices will, however, help to reestablish confidence in so far as fixed charges are reduced. The inflationary elements in the situation—the public works program, the large commitments of the Government which ultimately may involve forced sales of securities to the banks and hence expansion of deposits, if not inflation—may ultimately be responsible for higher prices; but these inflationary elements would do their work even if the price of gold were not manipulated through market and finally legal devices.

In announcing its new policy, the Administration has made it known that its intentions are to

increase the dollar price of gold and also to raise prices of commodities in general. Thus, having reduced the value of the paper dollar in terms of commodities, gold and foreign currencies, it will then revalue the dollar in terms of gold in accordance with its newly attained value in commodities and gold. Its policy is, first, the adjustment of prices to what is considered a proper level, and then the redefinition of the dollar, that is, devaluation. It does not propose to devaluate first, and then to seek the necessary price adjustments later. The latter method would remove the flexibility in our monetary system and require definite price and income adjustments; the former method allows the Administration some flexibility by not calling for any definite price changes—those are called for that can be effected.

It is a mistake to argue, as many have, that the American Government is *now* trying to control the value of gold and therefore is attempting an impossible task, as is evident in the failure to stop the decline of commodity prices in gold dollars in the years 1929–1933. It is because the Government has been unable to control the value of the ounce of gold, and therefore of the dollar convertible into gold at a fixed ratio, that more extreme measures have been deemed necessary. If the authorities are unable to control the commodity value of gold,

they *are* able to control the dollar value of gold; and, since obligations are paid in dollars, the task of reducing the burden of past obligations can be achieved by reducing the value of the paper dollar in terms of commodities. A preliminary step (according to authorities) is that the ounce of gold is to be made more valuable (higher priced) in terms of dollars, thus giving an impetus toward the creation of more dollars, for the available gold reserves will ultimately be worth (say) twice as many dollars. It is as much a mistake to argue that gold reserves have nothing to do with prices (as many of Mr. Warren's critics do) as it is to agree with Mr. Warren that the price level is determined by the dollar volume of our gold reserves.

Nor is it accurate to argue that the Government is anxious to attract large additional supplies of gold from all available sources; its reserve problems under a higher price level can be solved by putting a sufficiently high dollar price on an ounce of gold. The movement of gold to New York is, if anything, a symptom of failure, for it reflects a rise in the dollar price of gold not offset by a rise in the price (dollar) of commodities, the gold continuing to come only because dollar commodity prices have not risen sufficiently, and, therefore, because the value of gold in commodities rises in the United States

relatively to its value elsewhere. If prices of commodities rise in dollars as much and as rapidly as the price, in dollars, of an ounce of gold, the United States gains no competitive advantage; the higher price in dollars of gold is offset by the higher price of commodities in dollars and therefore the United States is not a more favorable market in which to sell gold (buy goods), for though gold buys more dollars, dollars buy less goods.

The presence of a new competitive advantage resulting from the more marked increase in the dollar price of gold than in the dollar prices of American exportable commodities is in itself a symptom of failure to achieve the *main* objective of raising commodity prices. Perhaps, for this reason, it is not exactly accurate to refer to the new gold policy as a planned currency war. New export bounties are the result of failure, not success. Furthermore, it is anticipated that the dollar will depreciate in terms of foreign currencies as the dollar price of gold rises and the sterling or franc price of gold remains unchanged. In other words, the decline in the value of the dollar in foreign currencies is an integral part of the Warren plan; but the introduction of a new export bounty is not. Obviously the depreciation of the dollar in foreign currencies arises from the fact that, while

Great Britain continues to bid £4 sterling ($20, say) for an ounce of gold, the American Treasury offers an increasing price for an ounce of gold, gradually raising it from $20 to $40. Should Great Britain continue to offer but £4 sterling, then since the dollar price of gold must be roughly equal in the two countries, the dollar will decline until £1 equals $10. The other alternatives are that Great Britain will also raise the price of gold or that gold movements will be restricted (as they are in a sense now) so that the need for a uniform dollar price of gold would no longer exist. The restriction of gold movements on the part of Great Britain, especially when the United States has acquired a new export bounty, would tend to bring about a depreciation of sterling, or at least a smaller appreciation of the dollar and the appearance of a British export bounty, or a smaller penalty on British exports.

The Warren plan is to depress the dollar by reducing its value in gold. Have President Roosevelt's advisors failed to take into account the fact that the dollar price of sterling may be determined directly by numerous factors other than the price of gold? In particular, large speculative movements against the dollar have as often as not been a decisive factor in depressing the dollar on foreign exchange markets, with the result that instead of the gold price of the

dollar determining the sterling price of the dollar, the sterling price of the dollar has determined the buying price of gold or at least has checked the rise in the price bid for gold by the R.F.C. Authorities have watched with surprise a decline in the sterling price of the dollar resulting from panicky withdrawals of capital rather than from a steady rise in the dollar price of gold. One might conceivably argue that the anticipation of a higher buying price for gold has been responsible for the premature decline in the dollar abroad; but the depreciation has been more than the anticipation of a moderate rise in the dollar price of gold. It has been the expression of the fear of a depreciation of a currency that has lost its anchor as well as an expression of doubts concerning the economic policies of the Roosevelt Administration and the economic future of the country. Those who have withdrawn dollars have done so on the assumption that their dollars or assets convertible into dollars would be worth little in the future, either because dollars would become too numerous and hence buy little, or because their claims would be convertible into relatively few dollars of stable purchasing power with the downward course of business.

We may have to ask ourselves once more to what extent are we willing to exchange our

valuable commodities for gold which we do not need and cannot use; but we shall probably never have to put that question to ourselves, for long before we attract much gold in this manner and improve our export position substantially, foreign nations will take protective measures—increase their purchase price of gold, introduce discriminatory tariffs against the United States, etc.

It is also necessary to note at this point that the struggle for gold engendered by the American Government at this time will undoubtedly lead to increased hoarding of gold in all countries, and, where it continues to circulate freely in exchange for local currencies and commodities, its value in terms of commodities will therefore continue to rise. Thus we may justly be condemned for accentuating a movement, that is, the appreciation of gold in commodities, which almost everybody will admit has been one cause of the depression. When the world is ready to go back to gold, the high value of gold in commodities will make necessary a greater degree of devaluation than otherwise would have been necessary.

The problem can be represented by the following table which is drawn up on the basis of a rough approximation to the facts and with a consideration of the objectives of the Administration:

| | Price of ounce of gold, dollars | Commodity prices, gold dollars of metallic content of 1932 | Commodity prices, dollars—gold before 1932, paper after March, 1933 |
|---|---|---|---|
| 1924–1926 | 20 to 21 | 100 | 100 |
| 1933 (February) | 20 to 21 | 60 | 60 |
| 1933 (October 21) | 30 | 65 | 75 |
| 1934 and later | 40 | 50 | 100 |

A devaluation of 50 per cent (approximately) is necessary in 1934 in order to bring the price level in gold, the dollar commodity price level and the dollar price of an ounce of gold into equilibrium once more. An ounce of gold is worth twice as much in dollars and commodities as in 1924–1926; a paper dollar is worth as much in commodities as in 1924–1926. Therefore legal recognition will be given to the established condition by coining an ounce of gold into $40 (the 1934 market price) instead of the normal $20 to $21. It may be noted that the new policy has contributed to a decline in gold prices from 65 to 50 and therefore makes more extensive devaluation necessary. In December, 1933, a tendency toward a decline in gold prices of commodities is already evident. One ought not to conclude too quickly that our gold policy is, therefore, a blessing because we now avert further declines in dollar prices; for the apprecia-

tion of gold may be associated in part with our gold policy.

## *Conclusion*

Reserves may be increased by devaluating, by issuing greenbacks or by undertaking large open market operations. The first method puts increased reserves at the disposal of the reserve banks, while the second and third put them at the disposal of the member banks. Both because the last two methods provide additional cash for the member banks, thus moving the cash one step further along toward the ultimate borrower, and because the unorthodox method, that is, devaluation, especially shatters confidence and interferes with the movement of cash both from the reserve banks to members and from the latter to the public, much may be said for the issue of greenbacks or open market operations, in contrast to devaluation, as means of raising prices. On the other hand, if large additional expenditures are planned for the future and a return to the gold standard is contemplated, devaluation may seem expedient; but we may remind the reader once more that large additional expenditures seem feasible now within the limits of the gold standard defined as it was in 1932. Of all these methods this may be said: They set the stage for excessive expansion

in the future, which may very well bring a crisis and serious maladjustments later. This is especially true if prices are raised to a level that the current supplies of money cannot maintain. Furthermore, any monetary measures that impair confidence in business will to that extent make necessary additional public expenditures; and, therefore, a larger volume of public expenditures will be required in order to raise prices to a designated level.

Officials have held that in preparing for devaluation by raising the dollar price of gold, the United States is merely trying, in a manner similar to Great Britain and France, to depress the value of the dollar abroad. To recognize the weakness in a country's international situation as evident in a depreciation of its exchanges is one thing; to try to depress the value of the dollar abroad by increasing the dollar price of gold and destroying confidence in the dollar is another. What is more, the dollar has been too valuable abroad in the last twenty years, as is evident in the tendency of gold to flow toward the United States; and whatever outflows have occurred in the more recent past may be associated with the loss of confidence following monetary experimenting and to some extent to the loss of confidence following bank failures and unsatisfactory business conditions which in turn

may be traced to a too highly valued dollar at *home*, not abroad. Devaluation tends to make the dollar cheaper for foreigners who want to buy our goods, although the dollar has been too cheap for foreigners (witness the relatively rapid decline in gold prices here since 1929). Because it further undervalues the dollar abroad (at least temporarily), devaluation can only be justified if it is a very effective method of dealing with the problems of the high value of the dollar at home. I do not deny that it may well contribute toward higher prices at home; but it may also bring serious disturbances. And is it the most effective and desirable method of dealing with the price problem?

To inflate or not to inflate? At the outset, I may say that it is unfair to argue that the only alternatives are no inflation, or possibly continued deflation, and a catastrophic degree of inflation. Moderate inflation or inflation controlled within broad limits has been known to occur in relatively normal times. On the other hand, it is much easier to stop inflation before it begins than to wait until it gets under way. Furthermore, the gain of inflation in lower costs is not likely to be of the dimensions that are generally expected. It may also be said that past experience is not an adequate guide of the possibilities of control of the rate of inflation,

because never has the public been so inflation-conscious and never has the government been provided with such effective weapons with which to inflate. On the other hand, the possibility of checking inflation at the point where equilibrium between prices and costs and prices of primary and finished products is once more attained may be greater because we know more about the process.

An early stabilization and a return to gold may help to reestablish confidence. Even a moderate devaluation (say 25 to 33 per cent) may be supported if it can be demonstrated to be a *sine qua non* for an independent monetary policy that will maximize employment. (The assumption is that gold reserves are inadequate.) The blow to confidence resulting from our new gold policy has already been felt; the act of giving legal recognition to that policy, while announcing the end of experimentation and assuring the public that a wild orgy of inflation is not on its way, may help to clear the air. Equilibrium may then be reestablished by a further increase of prices here of moderate proportion; but, unfortunately, equilibrium may be jeopardized by any program of stabilization or devaluation undertaken by other countries. If we agree with Mr. Warren that gold supplies are inadequate and therefore that a painful

process of reduction of prices along the entire economic front is in prospect, then (and only then) can the proposal to devaluate for the purpose of coping with the problem of the scarcity of gold be taken seriously. It would then be easier to adjust monetary supplies to the economic situation than the latter to the former. But has it been demonstrated to our satisfaction that supplies of gold, adequate in 1922–1929, have become *most* inadequate in 1930–1933?

# HELPING THE FARMER

*By* Wassily W. Leontief

## I

Most of the experts agree that the farmer's plight is due to agricultural overproduction. The meaning of this term, however, needs a careful interpretation. The mere fact that the production of any specific commodity increases, either in absolute amount or relatively to the output of some other goods, does not in itself present a case of overproduction.

From the consumer's point of view, a large supply always means an eventually improved welfare. The physical possibility of using the currently available amounts of agricultural products—or even much more—can hardly be subject to any reasonable doubt. There exist, however, two very rigid economic limits to the consumer's demand: one is the price of the commodities, which he is buying the other the site of his monetary income. High prices and low incomes may render superfluous the same output which under

lower prices and higher incomes would be considered only adequate or even insufficient. Every increase in the supply, accompanied by a corresponding price reduction, always benefits the consumer and increases his standard of living.

From the farmer's point of view, the situation looks quite different. He is principally and primarily interested, not in the consumer's welfare, but in the net return which he himself is getting from the sale of the product of his land. And such a return can be realized only as long as the expenses of production are lower than the prices obtained on the market.

The costs of production are as far from being uniform in agriculture as they are in any other industry. Some wheat growers in Kansas can put their product on the market for as little as 40 cents a bushel, while others, enjoying less favorable conditions, are unable to do it for less than 72 cents. Accordingly, one set of producers may enjoy large profits, while another just makes both ends meet, and a third group is incurring direct losses—all three selling at more or less uniform market prices. Under normal conditions, the last group constitutes a negligible fraction of the total farming population and is comparable with the small number of industrial unemployed who do not disappear even in the

time of prosperity. But if this submarginal group of operators, under the influence of unfavorable conditions, increases beyond the normal proportion we may speak of overproduction. This term is, however, somewhat ambiguous in so far as it suggests that such an unfortunate situation is necessarily and solely caused by some maladjustments on the side of the producers.

The state of perpetual and ever increasing overproduction which has characterized the condition of American agriculture since the last recovery period of 1922 cannot be explained by any single factor but is due to a multitude of different causes. On the one hand, there was the opening of new and exceedingly fertile areas, and along with this a progressive improvement in methods of cultivation (mechanization); the result of both developments was a remarkable fall in costs of production in certain agricultural regions. Those who were unable to follow the trend toward the new and lower cost level found the ground slipping from under their feet. On the other hand, the increase in the general living standards of the city population throughout the world caused a strong shift in demand away from the cruder kinds of cereals toward meats, dairy and other more refined food products. This change necessitated a considerable readjust-

ment of the whole agricultural production, and again those who were unable to follow the general trend found themselves under additional pressure.

On top of all this came the great general depression which cut away almost one-half of the industrial income. Naturally the demand for all commodities, including agricultural products, fell to an extremely low level, and the larger part of the relatively less efficient producers found themselves at once on the other side of the profit line.

Industrial enterprises, being run on a strictly commercial basis, were more or less automatically thrown out of business when no longer able to make both ends meet, and their collapse left behind an increasing army of unemployed workers and ruined investors. Thus a large part of the normal output of industrial goods was forcibly removed from the market. For this reason, the prices of industrial goods, although considerably reduced in comparison with their previous level, were prevented from reaching the low which they otherwise would have attained, had the ruin and forcible liquidation of so many producing units been averted.

The farmer showed a considerably greater degree of resistance against the unfavorable economic conditions. Agricultural production is still in a large part conducted on a non-

monetary basis. A considerable proportion of the operating costs are not direct monetary expenditures. Hence, even when depression caused the most spectacular reduction of his cash income, the farmer was still able to avert a final economic collapse. Even in the case of foreclosure, he was only in exceptional occasions forced to abandon his land. As a result of these special circumstances, the total output of farm goods was only slightly affected by the unfavorable economic condition of the last three years; and, for the same reason, the price slump on the agricultural market was nearly twice as violent as on the industrial. This means that the relatively higher price level of the industrial goods is primarily due to the fact that the agrarian population was able to avert the complete economic annihilation which swept away a large part of the industrial community. In other words, farm prices certainly would have maintained a considerably higher level if the forced liquidation which has taken place in industry had occurred to the same extent in farming.

This, then, is the situation which official relief measures have been designed to remedy. The large farm relief program was initiated by the Agricultural Adjustment Act of May 12, 1933, and is still in the making. For a short discussion,

the complicated system of laws and regulations may be grouped under three major headings: (1) mortgage relief, (2) reduction of the agricultural output (allotment plan), (3) direct bonus payment and taxation of farm products.

## *II*

For many different reasons, the critical farm credit situation deserves special attention. The mortgage interest payments constitute one of the major, and—what is even more important—one of the least elastic, items in the average farmer's monetary expenditure account. As has already been implied, the only effective defence which he is able to put up against the advancing depression is his ability to cut his monetary outgo. In view of this circumstance, the fixed amount of his interest payments becomes the crucial point of the whole situation. Hence it would be difficult to indicate any form of governmental assistance to agriculture which could be more appropriate and more efficient than an extensive mortgage relief program. A definite action in this direction is necessitated also by the fact that the solvency of the whole country bank system was seriously endangered by ever increasing bankruptcy figures.

In general, the emergency mortgage relief program may be characterized as a huge re-

financing plan on the basis of extensive governmental credits. The Reconstruction Finance Corporation has placed in the hands of the Farm Loan Commissioner 200 million dollars and, in addition to this, he is also empowered to meet any further needs by floating up to two billion dollars of Farm Loan Bonds, the interest on which is guaranteed by the government.

As in the case of any other credit transaction, the final success of this move depends upon the future developments. If the worst comes to the worst, a large part of the investment will eventually be written down as an additional government subsidy to agriculture. But even in this case, the governmental control may prove to be an efficient although a rather costly means toward reduction of the dangerously increasing agricultural indebtedness.

## *III*

The Agricultural Allotment Plan calls for a systematic reduction in the output of all the major farm products. According to current information, the following reduction ratios will be attained in some of the major "crops":

| | Per Cent |
|---|---|
| Cotton | 40 |
| Wheat | 15 |
| Corn | 20 |
| Hogs | 25 |

The purpose of the action is to increase the farm income through raising the prices of these major agricultural commodities.

The idea is not so simple as it appears to be at first sight. Higher prices with an unchanged or even increased volume of sales would certainly add to the producers' income. If, however, the whole action is based on a deliberate curtailment of the supply, the desired result can be attained only if the *price* rise is large enough to more than compensate for the reduction in the total *volume* of transactions. Even a most powerful monopolist cannot possibly regulate the amount of sales and the price independently of each other. If he fixes the prices, the amount of business will depend entirely upon the consumer's reaction to them; if he sets his mind on maintaining a certain level of output, it is again the consumer's response which will determine the appropriate price.

The agricultural adjustment plan in general gives preference to the second of these two alternative methods of supply restriction. In particular instances, however, important practical considerations made it necessary to introduce direct price fixing. In either case, the final success of the monopolist is determined by the urgency or elasticity of demand. Available statistics show that a cotton crop 15

per cent under normal was usually accompanied by an increase in farmers' receipts of about 12 per cent over the average. Similar conditions were observed on the potato and pork markets. In respect to other farm products, empirical evidence is less clear. But even without any statistical proof, it stands to reason that, farm products being primary necessities, a sufficiently strong restrictive pressure on the supply side can extract from the consumer almost any part of his income. According to preliminary estimates, the output reductions (excluding all the benefits of direct relief) will increase the farmer's income by about 500 to 600 million dollars, from 6 to 8 per cent of his present cash receipts.

The cost reduction which might be expected to occur in connection with the curtailment of the output will hardly be very large. Of the most important monetary expenditures, the interest and tax payments are fixed and do not depend on the current rate of output. The reduction of hired labor is not a real economy in so far as the farm help is a part of the agricultural population. The land rent will possibly have a downward tendency under the influence of an eventually reduced demand for agricultural sites.

In connection with the development of the current program of public works, a large number

of important land reclamation projects are under way. This may be considered as an additional contribution toward the reduction in the cost of production of agricultural commodities. These enterprises, together with some other measures aiming at more efficient farming, have been criticized as being somewhat paradoxical in the face of the drastic reduction of output. The contradiction is, however, in this case only an apparent one. A cost reduction is beneficial to the producers in any case, and under the régime of monopolistic control even more so, because here they are protected against the intrusion of competitive forces which may otherwise enforce a corresponding price reduction.

## *IV*

In addition to acreage restrictions, the agricultural adjustment plan provides for a measure of direct farm relief in the form of special bounty payments to the amount of approximately 400 million dollars. The distribution of this money is administered in such a way as to support the above-discussed output reductions.

Despite the obvious advantages of the general restriction scheme, it would be nearly impossible to enforce such a concerted action on the part of many millions of independent farmers. Even in the case of industrial cartels it has always

proved to be very difficult to prevent the individual members from deliberate transgressions of their production quotas.

According to the present agricultural allotment plan, the bounties are to be distributed among the farmers according to their individually contracted acreage reductions. Thus the benefit payments are used as a powerful additional incentive toward a voluntary curtailment of the agricultural output.

In spite of this ingenious connection with the supply regulation, the bonus has to be considered as an entirely independent relief measure. It could be equally well applied even if the restriction plan were never put into effect. As a method of direct assistance it belongs rather in the same category with mortgage relief.

## *V*

The money required for the distribution of the farm allotment bounties is provided by a system of special "processing taxes" affecting all the important agricultural commodities. Past experience with indirect taxation has proved that, in the natural desire to avoid an additional burden, the consumer inevitably contracts his demand for the articles affected by the new tax and makes the attempt to direct his expenditures in some other channels. This means that the

processing taxes imposed on farm products are in danger of defeating the original purposes of the relief program by reducing the demand for this kind of goods. In order to meet this danger and to block as far as possible the consumer's escape, an additional system of so-called compensatory taxes was imposed on those non-agricultural commodities which might be used as substitutes for corresponding farm products.

This raises an important practical question whether it would be possible to find some method of taxation which would indirectly increase the effectiveness of the supply restriction in the same way as the bonus payments are supporting the administering of the acreage reduction.

The single purpose of the allotment plan is to divert an additional part of the consumer's income toward the purchase of agricultural commodities. This end would evidently be served best if the farm products could be exempted entirely from any taxation and the total amount of money needed for the bonus payments collected exclusively through a system of "compensatory" taxes on non-agricultural commodities. As to the taxpayer's interest, after the total amount of additional levies is definitely fixed, the choice of an appropriate object of taxation is from his point of view practically immaterial.

In connection with the discussion of the processing taxes, a theory has been repeatedly advanced that a large part of the levy will be absorbed by the "middlemen." This expectation is based on repeatedly cited statistical evidence showing that, despite the unprecedented price slump of agricultural commodities, the costs of distribution have remained on a relatively much higher level and that, consequently, they are now absorbing an abnormally large portion of the retail price. This discrepency, deplorable as it is, has to be considered, however, as an almost unavoidable result of the general economic situation. In the opening paragraphs of this article, it was shown that with the advance of the depression many industrial enterprises were forced out of business because they were unable to maintain the equilibrium of their cash balances, while the agricultural producers, after contracting their monetary expenditures to an extremely low level, managed to avoid a final liquidation. We have seen that under such circumstances a price gap between the industrial and farm products was almost inevitable. But what is true in respect to industry applies to an even larger degree to the modern system of distribution. The investment in this case is confined almost wholly to circulating capital, and consequently the ability to bear financial losses is necessarily very limited.

It is not at all astonishing that under these conditions the trade apparatus proved to be the least elastic link in the whole system. For the same reason it is hard to believe that a significant part of the new processing taxes if any will be absorbed by the middlemen.

Along with the major relief measures, the agricultural adjustment program includes a large number of auxiliary provisions.

While the larger part of the yield of the processing tax is directly transferred to the farmer by means of bounty payments, a small proportion of it is assigned, among other uses, to governmental purchases of foodstuffs, which subsequently are distributed among the needy city dwellers. As a measure of industrial unemployment relief, this procedure is equivalent, though somewhat inferior, to direct monetary assistance. As a means of pegging the demand for agricultural products, it is comparable to the public works program in the industrial field.

Since the inauguration of the cotton crop restriction the Agricultural Adjustment Administration has bought up large stocks of cotton under a provision which enables the cotton farmer to buy it back at a low fixed price and resell with profit on the open market. Should such

profitable resale be impossible, however, the losses incurred are to be covered out of the governmental funds. Somewhat different in form but quite similar in substance is the pegging of demand through extending special loans to farmers with unsold wheat and cotton stocks as security. Should the market resume an upward trend, the farmer will sell his holdings and repay the previously received advances; otherwise the loans will be written off as a simple subsidy. Generally speaking, the whole scheme bears a striking resemblance to the recently abandoned Farm Board experiment which, incidentally, cost the government many millions of dollars.

## *VI*

In concluding this necessarily brief and incomplete survey of the most important points of the agricultural adjustment plan, it is impossible not to indulge in a few speculative considerations concerning the final means and ultimate ends.

In the face of the close organic interdependence among the different parts of the national economy, the distinctions between the agricultural, industrial and all the other relief measures necessarily bear a mark of artificiality The experiences of recent months have clearly demonstrated that the indirect repercussions of an energetic industrial policy (NRA) may affect

the agricultural situation nearly as much as deliberate farm relief measures. In some instances, such interaction may be positive in its character; in most cases, however, conflicting results are almost inevitable.

The tariff policy, for example, is the traditional field of such controversy between the agricultural and industrial interests. The unfortunate implication of this "competition" lies in the fact that it is very likely to lead to a never ending scaffolding of "compensating benefits." Every time the farm interests embark upon a new anti-tariff drive, it is safe to expect the inauguration of some additional farm relief measures; and once the taxes and prices of raw materials have risen, industry will not fail to demand and very often to obtain an increased tariff protection. And while this rivalry is going on, the total national income is affected most adversely; the gradual abrogation of the economic intercourse with other nations eventually unbalances the normal distribution of national labor between different employments and reduces its productivity.

The discussion of these questions lies, however, outside the scope of this article, which is concerned exclusively with direct agricultural relief plans. Manifold in its methods, this

program also is complex in its aims. First and above all, it is an emergency relief action, an oxygen tent which will help the patient in his struggle during the immediately threatening crisis. But, at the same time, the plan evidently contains many features of a more or less prolonged treatment, which is expected to bring about eventually a complete recuperation. It is safe to assume that with the progressive success of all the emergency measures, the last, the long-term aspects of the problem, will gain in prominence.

Any short-term relief program implies a transfer of income from one part of the population to another. The methods of this transfer may vary, some of them being more and some less obvious, but the real essence of the matter remains always the same. This does not mean that all these different technical devices are necessarily equally efficient, in other words, that the losses to one income group and the gains to the other are always identical. The agricultural adjustment program provides for a direct transfer of purchasing power through a combination of bounties on one and new taxes on the other side. Besides this it accomplishes an additional redistribution of income by means of a complicated system of supply restrictions. If the balance

of sacrifices and gains in these two instances is compared, it is easy to see that the direct method is decidedly preferable.

What really happens in the first case is a simple transfer of a certain number of dollars from the hands of the industrial population into the farmer's depleted pocket book. The total national income remains unchanged. On the other hand, the monopolistic technique of supply restriction also effects a similar transfer of purchasing power, but in addition to this the curtailment of the agricultural output automatically reduces the size of the total national income and this reduction evidently imposes an additional burden on the industrial population without diminishing by the same amount the suffering of the farmers.

Turning to the long-term aspect of the farm relief problem, we find that the final goal of the Agricultural Adjustment Act has been defined as the reestablishment of economic "parity" between industry and agriculture. The short sequence of years 1909–1914 directly preceding the World War is usually taken in this connection as the ideal period of reference during which the golden rule of parity was practically realized.

But the idea of parity can be applied in several different ways. It may imply:

1. Reestablishment of the old relation between the *price levels* of agricultural and industrial goods.

2. Reestablishment of the prewar proportion between the *aggregate incomes* of the total industrial and the total agricultural populations.

3. Reestablishment of the old relation between the *rate of remuneration* of capital and labor as applied to industry, on the one hand, and to agriculture, on the other; in other words, parity between the industrial and agricultural standards of living.

Only a forthright repeal of all the fundamental economic and technical changes which have taken place during the last quarter of a century could restore simultaneously all three different types of parity. Any other method of adjustment cannot possibly reestablish all three kinds of "equilibrium" at the same time. Under the changed conditions of technical efficiency in industry and agriculture and with the new standards of personal needs and tastes, the restoration, for example, of the old price relations would require a distribution of the national income absolutely different from what it was twenty-five years ago. On the other hand, if the

last kind of parity—equal remuneration of labor and capital and equal standards of living on the farm and in town—were to be chosen as the final goal of the agricultural adjustment policy, it is most probable that in comparison with the basic period 1909–1914 a much larger proportion of the total national capital, and a considerably larger part of the total population, should be devoted to industrial activity and a considerably smaller part could still find application in farming. Consequently, the industrial share in the total national income would increase at the expense of the aggregate farm income.

In order to realize the extreme intricacy of the problems involved, it is only necessary to assume for a moment that any one of the three types of parity will really be attained and subsequently ask ourselves what would happen in this case to the other two kinds of relations. A definite solution of such a problem would require a vast amount of research and the final answer in any case could be only a tentative one. But just because of this obvious difficulty a clear distinction among the three different meanings of the word "parity" is of the utmost practical importance.

The final choice among the three possible goals of a national agricultural policy is a purely political question. It is very difficult to attach

any definite political meaning to the demand for the reestablishment of price parity. Maybe it would be wiser to discard this slogan entirely and take up the cudgels in defense of either of the other two. But this controversy lies outside the scope of this discussion.

There exists, however, one aspect of the problem which should not be overlooked. The experience of the whole of the economic history of the United States, as well as of many other countries, has shown that at any time and in every place there exists a definite set of economic forces which are working toward the establishment of the third kind of parity, toward the equalization of the rewards of capital as well as labor in all the different branches of economic activity, including industry and agriculture. The effectiveness of these economic forces varies from place to place and from time to time, but it is impossible to find any instance where they are entirely absent. On the other hand, it is safe to say that there do not exist any economic forces which are working toward permanent stabilization of the relative price levels of agricultural and industrial commodities, or toward the perpetuation of the given proportion between the aggregate industrial and total farm incomes.

# ECONOMICS VERSUS POLITICS

*By* Overton H. Taylor

## *Economic and Political Realism*

THE foregoing essays in this pamphlet have dealt with parts of the New Deal, exclusively or mainly from the standpoint of the economics of recovery, in each case analyzing important economic facts conditioning the progress of recovery, and the probable effects, in the light of these facts, of measures embodied in the New Deal upon that progress. In other words, the criticisms offered have been based upon the economic realism which insists that policies aiming to promote recovery will, in fact, retard recovery if and where they fail to take account correctly of stubborn facts in the existing economic situation and of the arithmetic of business as it must be carried on in the economic system we are trying to revive. The antithesis of this economic realism is the vaguely hopeful or optimistic idealism in the field of

economic policy as such, which feels that good intentions, enough cleverness and the right appeal to the emotions of the people ought to insure good results, in spite of inconvenient facts. The arguments built upon facts, in the foregoing essays, are an antidote to "wishful thinking" of this kind.

There is, however, a similar error in the field of *politics*, which must also be avoided in any *fully* realistic discussion of the merits of the New Deal. If the valid arguments that start with economic facts only, and lead only to conclusions about the effects of policies upon recovery, are construed, in every case in which these effects are found to be unfortunate, as adequate grounds for immediate, total condemnation of the policies in question, this further inference is unwarranted. For it may be said to involve *political* idealism in the sense of the bland assumption that policies *ideally* adjusted to *economic* realities *must be possible*, in spite of all of the inconvenient *political* realities to which, in fact, intelligent policies must also in some measure be adjusted, in our complex world. Political appeasement is a necessary part, although it is not the whole, of the effort to promote recovery; and only wishful thinking, or no thinking, about political possibilities could lead us, the authors of this pamphlet, to take the

leap beyond our findings which have to do only with economic results of measures now in force, to final judgments unrestrained by any serious attempt to face the question whether, in view of the political situation created by the depression, the less fortunate measures in some cases may not be, in large part, the practical alternatives to *worse*, not better measures.

My colleagues, however, in their contributions to this pamphlet have not taken this leap, from judgment or appraisal of one set of results in the light of one set of data, to any absolute or final judgment; and in undertaking, as my contribution, to say something about political and other non-economic considerations which a final judgment must take into account, I am *not* undertaking or proceeding *either* to criticize any legitimate interpretation of their views *or* to interpret away anything of the very definite, real and substantial force of what is adverse to the New Deal in their findings about its economic results. As it is one thing to say that a policy is hindering, not helping, recovery, and another to condemn it without asking whether, through political appeasement, it is not preventing resort to policies even *more* detrimental to recovery, and in this very different sense *relatively* aiding recovery, or doing as much to aid it as can be done in the circumstances; so also,

it is one thing, even if we reach this latter conclusion in a given case, to justify the policy on grounds of political necessity, and another to gloss over or deny or minimize the fact or the importance of its still unfortunate economic results.

For if we assume that political necessity makes economic error less erroneous, wholly excuses it, or makes it useless or inadvisable to point out the error and insist upon it, we assume that political necessity is absolute; that the wishes of the people cannot be changed in the least by education in economics, or by the economic lessons of political experience, so that the government is bound simply to cater to those wishes as they are and can have no degree of freedom in its choice of means in the effort to retain its prestige by serving their real interests. It is really this attitude of political fatalism, and not the sound political realism of which it is the unsound exaggeration, that so often leads high-minded men in office, and students of politics or political science, into the illusions of the over-sanguine economic idealism that refuses to admit the limitations imposed by economic necessities upon the possibility of giving all groups of citizens their hearts' desires through governmental action. It is human nature to believe that what is strictly inevitable must be beautiful and

good; and the statesman who feels that for him the voice of the people as he understands it is the voice of Fate is likely also to feel that it is the voice of God, correctly and certainly, in spite of mere economic laws, revealing the way to better times and a better order of things.

The converse error, against which economists, that is, those who *are* economists, not politicians, and who know their science well enough to know that there *are* economic laws, need to be on their guard, is exaggeration of their economic realism into the kind of economic fatalism that, in practice, carries with it an illusion properly described as political idealism. Economic necessities are real, but they are not absolute; that is to say, the hard facts of the economic situation upon which the government tries to act, and the laws or the logic inherent simply in those facts, do in very definite and decisive ways confine within rather narrow limits the range of real possibilities and the greatest possible measure of accomplishment in the way of successful governmental action to improve the lot of all the people, or of any very large body of the people; but they do not limit the government to *one only* possible or economically defensible program in respect of any or all items of policy. And the one they indicate as *ideal* in the sense of being *ideally* adapted to the economic situation and the end

of maximizing the sum of economic benefits to all, attainable in that situation, is practically certain *not* to be in the range of *politically* possible programs.

In other words, the right attitude for both economists and political experts is one in which the special "realism" of each group restrains or limits or makes realistic the "idealism" of the other. Complete or perfect adaptation of policy to economic facts alone is never possible, because the conflict of human interests, ideals and wills, which is politics, forever makes this impossible; and just as definitely, the unsurpassable limits of economic possibility must forever preclude any complete fulfillment of the popular will.

## *The Nature of Politics*

The political forces that interfere with or prevent any full attainment of economic rationality in national policies are always in evidence to some extent, even in "normal" times, and are always greatly intensified in the political situations that develop in the course of severe depressions. These forces are political pressures brought to bear upon the government, by the numerous overlapping groups and classes or great "interests," sections, industries, etc., of which the nation is composed, in favor of measures that benefit the groups which manage

to "put them over," in each case at the expense of some or all of the other groups. But it is political idealism, disillusioned, that is, embittered or otherwise, not in any case true realism, to blame *merely* the reprehensible group selfishness or cupidity of all these national estates or "interests," and the selfishness, stupidity and low cunning of politicians who serve them, for these political battles and resulting measures of national policy which interfere with the restoration of equilibrium in the national economic system.

The greatest names in the history of real political science or political realism are the names of Machiavelli and Hobbes; and we still can learn from them the basic general fact of all politics—that the measure in which any man or body of men *can afford* to refrain from trying to use political and other available forms of power, to gain advantage over others in the same society, is only the measure in which a like reciprocal restraint is practiced by or imposed upon all others in that society. In the great society of nations, this hard fact accounts for the extreme difficulty of the problems of disarmament and international peace. The common interest of all in ending the costly and dangerous struggle for power, and accepting modestly defined rights and some impartial, peaceful

method of adjusting claims is entirely clear; yet no one nation, whatever may be the illusions of its pacifists or international political idealists, can afford not to use its strength to get more strength, wherever possible at the cost of others, so long as *the others* are doing the same thing. And within each nation, in spite of the large extent to which effective government may restrain and civilize the struggle, the entire political process is essentially a struggle of economic groups and classes, sections, industries, etc., catered to by struggling parties, to gain and use political power and get the greatest relative advantage by a suitable reshaping of all available and serviceable economic policies of the state.

In this political warfare, no politician or political party or faction can afford to sacrifice or gravely endanger his or its political life, by obeying a much higher or more scrupulous code than that on the average maintained for all, by such traditions of honor and fairness and devotion to the service of the nation, not of partial or special interests, as the nation in question may have managed to evolve. It is folly to blame any man or body of men in public life for doing in office—or in getting and holding office—the things that have to be done in order to survive in politics because in that game

everybody does them against everybody else—because they are the existing rules of the game. The only hope lies in slow improvement of the rules; and any nation is fortunate if the unwritten rules of its political life are good enough to save it from flagrant general corruption in times of peace and plenty, and from inevitable resort to real dictatorship or civil war in times of defeat or lowered status in the international struggle, or of economic depression at home.

Moreover, even more important than full recognition by their critics of the hard realities that men in high and low public office in the nation have to face, in the shape of the moves on the part of their political rivals which have to be met or anticipated in kind, is an equally full recognition of the corresponding fact about the positions of the great economic groups or interests in the nation, whose support these men in office require. No one, great group of this kind—the farmers, labor, the business class, the bankers, Wall Street, tariff beneficiaries, creditors, debtors, tax payers, tax eaters or any other group with a common interest in one side of any possible political issue—*can afford not* to exercise upon the government, through its votes and its lobbies and all the weapons it can use, enough political pressure and unscrupulous cunning to bend the policies of the government

in its favor if it can, to an extent at least sufficient to make up for its losses in this game to other groups at other times in the past and future, and on other issues in respect of which it may be losing at the current time. The penalty of failure or inability to exert enough pressure to offset, on the average over the long run, the opposing pressures of other groups gaining governmental favors partly at the expense of the given group is slow or rapid decline into poverty under the influence of governmental policies insidiously operating to alter the distribution of wealth in favor of successful groups. And any group that does not utilize the opportunities afforded by the existing rules of the national political game, or within these rules do as much of what it can do as it must do in order to hold its own in the struggle, is not virtuous but foolish, so long as the rules and the conduct of the other groups are what they are.

Yet while political realism must insist upon these facts, economic realism must, no less, insist upon the no less evident facts, that this political struggle among economic groups is a thing at all times detrimental to the economic progress of the nation; that in times of depression, when the struggle becomes more intense, it hinders national recovery; and that every group has an interest in cessation of the struggle,

or in such restriction or mitigation of its scope and methods as is possible, which is as clear as its interest in at least holding its own in the struggle, as long as the latter confronts it as an inescapable fact. Direct and indirect costs or losses incurred by every group in waging the struggle are deductions from any relative advantage it may be able to gain; the national income and wealth are less than they would otherwise be, because the struggle and its shifting fortunes cause continual dislocation of the economic system and reduce its efficiency, and in gaining a relative advantage over others any group can gain only an increased fraction of a lessened total; and the constant threat to its security is a gambling risk, against which it can have no adequate insurance, in the average winnings it may stand to gain over any long run of time.

The real economic interest of every group or segment of the people must lie in an all-around renunciation or very stringent limitation of "class legislation" and of the underlying struggle for power and relative advantage, *unless* some one group or class can really hope to carry through a social revolution on the Marxian model, abolish, that is, absorb all other groups, and create entirely in its own interest the

wholly new economic and social structure of the "classless" society. There are only these two conceivable ways of escape from the costs and hazards of a struggle, the existence of which is detrimental to all, in spite of the fact that, while it exists or continues, some groups may, for a time, gain more, or lose less, than others. If any one group could continue indefinitely to gain by the struggle, at the cost of the others, that group *would* in time be able to reshape the social order entirely to its own maximum advantage. The problem in this respect is similar to the problem of international peace. If any one nation in the modern world could grow strong enough to conquer and annex all the others, it might establish a "Roman peace," like that in the ancient Roman empire, and in the end confer an economic benefit upon all peoples. But as this solution is clearly impossible among nations in the modern world, the nations are being forced, by economic realism as well as by ethical ideals, to face the desperately hard task of reaching a general binding agreement giving every nation the security without which it cannot afford to disarm and give up all the procedures of "power politics" in the conduct of its foreign affairs.

As the Roman solution of the international problem is impossible, so also, at least in this

country, the Marxian or any similar solution of the other problem is, I think, clearly impossible, in any visible future. We have never had in this country, and there is no prospect that we ever shall have, a straight or simple "class struggle" involving only two important classes and conforming, in its evolution, to the Marxist pattern. Our "capitalist" class is internally divided into groups with rival interests as important as their common interest in resisting the demands of labor. American labor is likewise not homogenous; the "aristocracy of skilled labor" is not proletarian, and even our real proletariat seems likely, in view of the character and effects of recent technological advance, to continue only as a decreasing, not increasing, fraction of our population; for if such advance in a measure threatens the position of skilled labor of the old types, it now calls rather for increased numbers of technicians of many kinds, than for great masses of unskilled labor. The farmers are a large bloc by themselves, with some interests on the side of industrial and financial capital as against labor, other interests the other way in that conflict, and its own most important unique interests opposed alike to those of urban labor and of urban capital. Above all, our large and important and by no means disappearing or

declining "middle class," of people in all the professions, petty businesses, "white collar" occupations and the like is likely to continue to hold the balance of power among all classes and make it impossible for any group to work its will completely upon all others.

The interest, then, of every American group still lies in some agreed limitation of the special claims of every group by those of all the others. Our essential difficulties lie in the weakness of restraints effectively imposed by our system of law and government upon particular or special interests and their efforts to exploit one another—a weakness which lessens the security of every group and leads, in times of depression, to just such desperate struggles of rival groups for contradictory forms of "class legislation" as are manifested in the New Deal. The rivalry of industrial and financial "capitalist" groups, in times of prosperity, in division of the spoils of exploitation of labor, the farmers, consumers and small investors, intensifies the ensuing depressions and evokes in depressions the bitterness of the formerly exploited groups which leads them, in the access of political power which they gain in the time of general distress, to become in their turn exploiters of the "capitalist" groups and of one another, employing as weapons forms

of legislation tending not to renew prosperity for all, but to redress the balance of advantage in the complex intergroup struggle.

There is thus a genuine problem of reform in our social order, indissolubly bound up with the more immediate problem of recovery from this depression. In the circumstances, some concessions to the spirit of revenge or sense of justice on the part of groups formerly exploited in "prosperity" are inevitable; and although in the absolute sense they hinder recovery, they may, if skillfully made, contribute, through political appeasement, a relative assistance to recovery in the way of prevention of alternative measures still more detrimental to it. But the fundamental problem of reform is not that of appeasing present demands for redistribution of wealth and retribution upon capitalist groups; it is the problem of imposing new and more effective all-around limitations upon the future power of every group to exploit the others, and securing now as much limitation of the intergroup struggle for relative advantage in legislation as is compatible with immediate political necessities, in order that the handicap imposed by this struggle upon general recovery may be made as small as possible. The effort to solve—as well as they can be solved together—the economic and the political problem facing the administration in-

volves an effort to solve the ethical problems of reform; and the latter must be approached in terms of a general view of the evolution of our American social order.

## *Building a New Order*

The *laissez faire* ideal of government, which on the whole has been the dominant American ideal until the New Deal came along, was in its origins precisely the ideal of an all-around renunciation of and binding guarantee against all special interest legislation, and all forms of the struggle for power and advantage over others, in economic and political life. If we roughly translate *laissez faire* as "let alone," it never meant that the government should in all matters let business alone, or let the people as individuals or as groups and classes alone, in their business dealings and relations with one another. It meant, rather, that the government should compel all classes and individuals to let one another alone, or keep their hands off of wealth belonging to others, and should itself let alone the pursuit and the fruits of honest labor, investment, enterprise and commerce, or refuse to let itself be used as the agent of any group seeking to gain at the expense of any other. The ideal was ethically as well as economically tenable; the weakness was not in the ideal as

such but in the program of measures for its attainment, and was due to an underestimate on the part of the "liberal" idealists, who framed this program, of the strength of forces opposed to the realization of their ideal—the forces of particular as opposed to common interests, and of the unscrupulous greed and cunning manifested in evasions of constitutional and civil law, in the struggle for power and relative advantage in the fields of business and of politics.

The cornerstone of the "liberal" program was the law and ethics of property and contract, which in spirit or intention are the law and ethics of common honesty in all business relations, and in the relations between government and business. Honest business is not pursuit of power and advantage over others; it is production and exchange of goods and services on terms of *mutual* advantage to both parties in every transaction. The liberal theory relied upon universal freedom of contract, respect for the property rights of others, and the general prevalence of competition among many sellers and among many buyers in free markets, to guarantee the mutuality of advantage in every transaction in such markets, by giving each party alternative opportunities to use in bargaining, or opportunities to seek the bargain most to his advantage. The possession by *all* of such opportunities

carries with it as consequence a lack of power on the part of *any* citizen or group to gain a one-sided advantage, exploit others, or compel them to accept bargains not in like measure advantageous to themselves.

Discouragement of monopoly, and strict regulation by the state of any and all actually emerging monopolies, always have been integral parts of the actual program of *laissez faire* or economic liberalism, and of the corresponding legal theory of private property. The property rights of every citizen are his rights to what he can lawfully and honestly obtain for his services or products in open, free or competitive markets, and, if he has a monopoly, to what he *could* obtain for the same investment of labor and/or capital, in producing other things to sell in free markets. If he gains more than this, he is confiscating the property of others; and the regulation of all complete or partial monopolies by this criterion is only one implication of the basic ideal behind the law of property and the program of *laissez faire* for enforcing honesty in all business relations. This one implication logically covers not only things traditionally recognized as monopolies, but equally the much more widespread forms of partial monopoly only recently discovered or apprehended in their full significance by economic theory; although in this case, as in

much of the liberal program, reliance must in practice be placed much more in the development of effective, high, informal standards of "business ethics" than in the strong arm of the law. Besides abuse of monopoly powers, all violations of trust or confidence, of fiduciary obligations, all forms of misrepresentation and fraud in advertising and in selling goods or securities, the use of opportunities to exploit labor (in most if not in all cases arising from partial monopolies, in this case of readily available jobs, on the side of the employer) and other things of these kinds are, of course, ruled out by the ideal.

The failure in the past to achieve a more adequate realization of the ideal of economic liberalism has been due to persistent misunderstandings which grew out of the fact that its early advocates saw only one side of the practical task before them, in anything like realistic terms. The forms of interference of unscrupulous group interests with equal liberty and opportunity for all individuals, against which the early battles of liberalism were directed, were those directly involving the use of the powers of government, law and custom to close markets to members of rival groups; and the "negative" character which liberalism assumed as a protest merely against "restrictions" of one sort became a dogma which blinded later adherents to

the development of other evils requiring new measures of regulation, logically demanded in view of those evils by their own ideal. And this failure to develop the positive implications of the ideal has caused it to fall into increasing discredit, so that opposition to these modern evils has unfortunately tended to become the monopoly of new radicals who are not *economic* realists.

The lack of realism in the views of the older liberals was not at all in their views within the true field of economics, but in other views in what is properly the extensive field of political science —the science of "politics," as a class of activities appearing in the field of business or of private pursuits, as well as in the field of government. True realism requires us to build upon observable facts, but it also requires us to make and consistently adhere to the logical distinctions without which we are bound to confuse different problems and different aspects of the facts that we observe. Economic science is the science of situations and activities involved in the effort of society and its members to achieve economy, or efficiency, in the use of material resources and of labor to increase wealth, or the supply of means of satisfying wants; and all that has to do not with this quest for efficiency, but with the struggle for power and advantage over others

in the distribution of its fruits, is of the nature of political activities, realistically conceived as such by Machiavelli and Hobbes, and belongs in the domain of political science.

Such things, for example, as the rivalry of groups of great capitalists or financiers for control of industrial empires, and the rivalry of different trade unions for control of employment in certain trades, are not forms of economic competition at all, but political campaigns, of the same nature as the rivalry of political parties or factions and underlying supporting groups in the electorate for control of the government. Most actual business competition is a mixture, in some proportion or other, of true economic competition, that is, rivalry in efficiency of service to the public and competitive bidding for the unforced patronage of the public, with the Machiavellian rivalry for power to manipulate markets, deprive the public of alternatives, or mislead it in its judgment of alternatives, and obtain the rewards not of superior efficiency but of superior strategic power and position. This second type of business rivalry frequently entails the use of pressure upon the government for removal of legal impediments that stand in the way of the designs of one business faction, or creation of new legal obstacles to block the designs of the opposing faction; but whether it

entails this or not, in particular cases, the end sought—the spoils of victory in a struggle for power—and the means employed—manipulation of opinion, maneuvers putting opponents and often sectors of the public in positions permitting only a choice of evils, surprise tactics and the like—in all cases make this kind of activity describable only as the politics of business, not economic competition.

The economic realism of the early advocates of *laissez faire* appeared in their recognition of the fact that the common interest of all citizens in the efficient regular functioning of the total system of economic activities requires suppression of the interference with this system, of political activities growing out of the mutual warfare and insecurity of special interests, and carrying with them rationalizations of those special interests, or fallacious views of the common interest, really originating in them. But a lack of political realism led those reformers to suppose that severe limitation of the power of the government to interfere at the behest of special interests would be sufficient, for all time, to remove the evil. They assumed that repeal of the old forms of governmental interference would result in the emergence and endurance of pure or perfect economic competition as the only form of actual business competition; and it logically

followed that it would result in a perfect harmony, under these new conditions, of all private or particular interests with the economic interest of the public as a whole. The error lay in failure to foresee the development, within the business world itself, of large-scale units and groupings, corporate, capital structures and the like, inevitably leading to new forms of direct political warfare among these entities, supplemental endeavors to control and misuse the machinery of government, exploitation of labor, agriculture and consumers, and retaliation by the latter groups through pressure on the government for undiscriminating, punitive and restrictive measures aimed against "big business."

The task of suppressing the interference of all forms of "politics" with honest business and with the economic system as such has thus grown to be, in our time, a task more urgent than ever, extremely difficult, and requiring of those who undertake to show the way a combination of economic and political realism that is usually absent among conservatives and radicals alike. Political realism must recognize that the prior condition of any abatement of the efforts of the radical political leaders of the discontented classes, labor and the farmers, to exploit and oppress honest and dishonest business alike, for the benefit of those classes, is reform of

dishonest business and elimination or control of practices involved in the power strategy of business interests. Men must have security against the intervention of governmental and other superior forms of power against them in their markets, if they are not to take all the revenge that they can when they, in turn, have the power. And, on the other side, economic realism must recognize that, in our present situation, the common interest of all in a general recovery of honest business, agriculture and employment is most endangered by the power strategy and economic illusions of the discontented classes; by the passion for reform that indiscriminately attacks, along with real abuses, the normal practices and gains of honest economic competition; and by the fallacious economic theories or fallacious views of the way to recovery for all, which are rationalizations of the rival demands of different groups in distress.

The ethical reform and regulation of industrial competition and finance, in the effort to make a higher standard of honesty possible for each unit in the business and financial worlds, by enforcing a higher standard upon all, is an aim which must have the ungrudging support of all true "liberals" in the older sense of the word, and of all intelligent conservatives. It is dangerous to attempt too much just now in the way of such

reform, because the uncertainties attending its progress add to the difficulties even of honest business and impede recovery. But it is more dangerous to hold back too much and not push needed reforms now, because the millions who want reform as well as recovery know that they will not get reform if they wait until recovery is complete; and if they are not assured that real reform is under way, they will support increasingly radical, undiscriminating, destructive measures. Perfection is not attainable in this world, in the average honesty of business men, of politicians or of any class; but the penalty of failure to make progress in these matters may be retrogression and collapse.

Yet no real friend of progress in the creation and enforcement of higher standards of business ethics will refuse to heed words of caution. The spirit of resentment and retaliation is not disinterested idealism or the truly ethical spirit, but it often wears the mask of the latter; and even the most genuine idealism in this sense of the word is not enough. The task is not one for emotional thinking; it is a technical task of great complexity, difficulty and delicacy. To attack conspicuous individual financiers for doing in the boom years things that were within the rules of the game of high finance as all their allies and rivals played it in those years, or things they more or less had to do in self-defence, the rules

being what they were, is both pointless and unjust. Attention should be focused only on the rules of the game. And in the effort to improve the rules, care must be taken to frame them in full view of the real necessities of honest business, in order not to interfere with the indispensable services to the public of institutions and groups which do render such services, even when they are accompanied by indefensible and harmful practices, which must be sheared away while leaving their ability to render their real services intact. The recklessness of ignorant emotional efforts at reform must be held in check, in order to minimize the risks that discourage honest business, while reforms are in the making. And above all, the new codes and regulations must not be allowed to take on forms that will be likely to make them, in the future, new weapons in the power strategy and rivalry of business and other political groups, instead of dampers on that game.

Besides doing all that can be done with safety now, in the way of this kind of reform, the government also is bound, of course, while depression lasts, to give generous aid in various ways to the millions who are in severe distress. But, here again, it is folly to think that only ungenerous or unsympathetic critics will urge realization of the limitations imposed upon the amount of honest, effective and safe generosity

possible, by the necessary conditions of the business recovery without which as a concomitant there can be no recovery of agriculture and employment. The wealth of the wealthy cannot all be transferred to the poor, by governmental measures in aid of the latter, and still be available for use within business itself, as capital or the wherewithal to carry on a business recovery; for this recovery cannot be financed in its first stages by an increase of consumer buying —there has to be an increase of investment, that is, investment in new production, long *before* the new products result in products that reach consumer markets. But a still more important point in this whole field of discussion is this: We must get rid of the illusion that, if any two groups, say labor and the farmers, will aid each other to recover by submitting cheerfully to governmental measures that seek to aid each group partly at the cost of the other, they will then be able to enrich each other in a cumulative fashion by exchanging their newly acquired amounts of "purchasing power." As far as each group bears the costs of aid extended to the other, the sum of their net amounts of purchasing power is unchanged. But the crooked theories bred of rationalizations of rival interests or political demands always point to gains in "purchasing power" and juggle the costs or offsetting losses out of sight.

There is also a danger that the effort to balance rival claims upon the government against each other, not by the economically sound method of limiting each by the other or not conceding too much to either, but by the economically unsound method of giving each as much as seems politically expedient, at the cost of the others, will become a precedent and make this policy of mutually canceling subsidies more than ever a lasting tendency in our future scheme of things. The tariff benefits industrial producers competing with imports in the home markets, partly at the cost of the farmers; the farmers have learned to counter this with good political weapons of farm relief; but the damage done to the common interest of all is not lessened, but redoubled, when we simultaneously give both groups what they want. The reward of all labor in goods, or the standard of living of the whole nation, is lowered by increasing the cost to all consumers of both industrial and farm products. Economic realism requires us to see political justice to all groups in terms not of equally generous concessions to all, but of equal resistance to all such demands.

The real economist's utopia is now and forever laissez faire, in the sense not at all of inactive government, but of a scheme of policy eliminating all interference of all "politics," or the power strategy and rivalry of special interests

in the fields of business and of government, with the orderly, efficient functioning, in the common interest of all, of the system of purely economic activities. Like all utopias really worth our allegiance, this one is, in its full perfection, unattainable. In contrast with it, what may be called the politician's utopia is a social order in which political forces have free play, in a government equally generous to all politically influential, special interests. It is a fortunate fact for the common welfare of all that this utopia, also, is unattainable in its full perfection, unless mankind should lose the faculty of reason. Our New Order must be a realistic compromise between two unattainable ideals. In the measure in which we are able to suppress "politics" within the business world, we may be able to have government in the common interest of all, not government controlled by "politics." But in the measure in which the power strategy of business interests, in business and in the dealings of the government with business, continues to result in exploitation by those interests of the larger mass of the people, we must expect and allow the great segments of that larger mass to organize their own, offsetting power strategy, and become exploiters in their turn, when they have the chance.